

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer Question No. 1 which is compulsory and any two of the rest from this part.

PART A

Question 1

- (a) On 8th February, 2009, The Hindustan Times published a news caption “Crisis of unimaginable proportions — Fraud @ Satyam. Company running out of cash to pay salaries — faces lawsuits.”

It further remarked : “The country is rocked by possibly the biggest corporate fraud. The company’s profits and cash reserves had been doctored for several years with possible connivance of auditors.” Obviously, the company had committed breach of good governance practices and legal bulwarks.

If you have to investigate into this case, which aspects of Corporate Governance would you look into ? (10 marks)

- (b) Choose the most appropriate answer from the given options in respect of the following :

- (i) Corporate governance means —
 - (a) Corporate management
 - (b) Corporate administration
 - (c) Corporate planning
 - (d) Corporate system.
- (ii) Board of directors play a pivotal role in ensuring —
 - (a) Good meetings
 - (b) Good management
 - (c) Good administration
 - (d) Good governance.
- (iii) Remuneration Committee of the Board should have —
 - (a) Six members
 - (b) Independent director as its chairman
 - (c) Company Secretary as advisor
 - (d) No interested director.
- (iv) The aim of internal control system is to —
 - (a) Boost company image in market
 - (b) Rationalise the company affairs and activities
 - (c) Help company in achieving its goals
 - (d) Keep check on internal management.

- (v) *Shareholders can apply for winding-up of the company under section 397 read with section 399 of the Companies Act, 1956 in case of —*
- (a) *Oppression and mismanagement*
 - (b) *Misbehaviour of managing director with shareholders*
 - (c) *Company insolvency*
 - (d) *Failure to pay debts.* (1 mark each)
- (c) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *Audit committee is more of a formality than an independent regulator.*
 - (ii) *Insider trading is permissible with the sanction of the SEBI.*
 - (iii) *Government regulations and public policy tend to bring the bare minimum involvement by the corporates towards their corporate responsibilities.*
 - (iv) *Clause 49 was incorporated in the listing agreement in February, 2000 by the SEBI.*
 - (v) *The matters required to be included in the directors' responsibility statement are to be included in the directors' report.* (1 mark each)

Answer 1(a)

One of the most appropriate definition of Corporate Governance (CG) has been given by ICSI, i.e. Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustained development of all stakeholders. Its principles are:-

1. Sustained development of all stakeholders
2. Effective management and distribution of wealth
3. Discharge of social responsibility
4. Application of best management practices
5. Compliance with law in letter and spirit
6. Adherence of ethical standards

Satyam failed fundamentally on counts of integrity, probity and ethics. The very intent of the promoter directors was to siphon-off the funds of the company to fuel their insatiable greed to amass wealth.

The accounts of Satyam did not reflect true and fair views of the state of affairs of the Company. The auditors, after the confession by the managing director; stated that the accounts of Satyam could not be relied upon.

One the face of it Satyam was a compliant company but the intent of the promoter directors was to defraud.

Some of the issues that should be investigated in the Satyam case include

- (i) Transaction with related parties

- (ii) Violation of SEBI (Substantial Acquisition of Shares and Takeover) Regulations;
- (iii) Violation of SEBI (Prohibition of Insider Trading) Regulations
- (iv) The nature of information placed before the Board and the Audit Committee.
- (v) The role of the internal auditors
- (vi) The role of the statutory auditors
- (vii) The role of Chief Financial Officer
- (viii) The role of the Company Secretary.

Answer 1(b)(i)

- (d) Corporate System

Answer 1(b)(ii)

- (d) Good Governance

Answer 1(b)(iii)

- (b) Independent director as its Chairman

Answer 1(b)(iv)

- (c) Help company in achieving its goals

Answer 1(b)(v)

- (a) Oppression and mismanagement

Answer 1(c)(i)

Incorrect

An Audit Committee oversees the financial reporting process of a company.

Answer 1(c)(ii)

Incorrect

Insider Trading is not permissible even with the permission of SEBI.

Answer 1(c)(iii)

Correct

The laws in India takes care of just the basic Corporate Social Responsibilities through various legislations under labour laws.

Answer 1(c)(iv)

Correct

Clause 49 was incorporated in the listing agreement in February 2000 by SEBI, as part of its endeavour to improve the standards of Corporate Governance.

Answer 1(c)(v)

Correct

Matters required to be included in the Director's Responsibility Statement are to be included in the Board's report in terms of clause (2AA) of Section 217 of the Companies Act, 1956.

Question 2

(a) *Write notes on any two of the following :*

(i) *Objectives of legal compliance committee*

(ii) *Internal control system*

(iii) *Risk management process.* (5 marks each)

(b) *Distinguish between 'corporate blogging' and 'company's vertical communication'.* (5 marks)

Answer 2(a)(i)

Due to complexity of compliance with the provisions of a number of applicable laws, it has become necessary that the Board of Directors constitute a non mandatory Corporate Compliance Committee & ensure due compliance with laws and procedures applicable to a legal entity. Such a Committee may also be called Legal Compliance Committee.

Objectives of Corporate Compliance Committee

The primary objective of the Compliance Committee is to review, oversee, and monitor:

- the Company's compliance with applicable legal and regulatory requirements,
- the Company's policies, programs, and procedures to ensure compliance with relevant laws, the Company's Code of Conduct, and other relevant standards;
- the Company's efforts to implement legal obligations arising from settlement agreements and other similar documents; and
- perform any other duties as are directed by the Board of Directors of the company.

The duties and responsibilities that can be delegated to the committee include:

1. To oversee the company's compliance efforts with respect to relevant company policies, the company's Code of Conduct, and other relevant laws and regulations and monitor the company's efforts to implement legal obligations arising from agreements and other similar documents;
2. Review the company's overall compliance program to ensure that it is well communicated, supports lawful and ethical business conduct by employees, and reduces risk to the company for non compliance with laws and regulations related to the company's business;
3. Review complaints received from internal and external sources, regarding matters

other than the financial matters which are within the purview of the Audit Committee;

4. Review the policies, programs and procedures for ensuring compliance with relevant laws, the company's Code of Conduct, value statement, other relevant standards, and legal obligations, including those imposed by settlement agreements;
5. Presentation to the Board for adoption of policies, for adoption appropriate changes to the policies, and oversee implementation of and compliance with these policies;
6. Review regularly the company's compliance risk assessment plan;
7. To discuss any significant compliance issues with the Chief Executive Officer;
8. To investigate or cause to be investigated any significant instances of non compliance, or potential compliance violations that are reported to the Committee;
9. To coordinate with other Committees regarding matters brought to the Committee's attention that relate to issues and compliance with applicable laws and regulations;
10. To regularly report to the Board on the Committee's activities, recommendations and conclusions;
11. To discuss any significant compliance issues with the Chief Executive Officer;
12. To periodically report to the Board and CEO on the adequacy and effectiveness of the company's compliance program.

Answer 2(a)(ii)

Internal Control System

Internal control is defined as a process, effected by an organization's people and information technology (IT) systems, designed to help the organization accomplish specific goals or objectives.

It is a means by which an organisation's resources are directed, monitored and measured. It plays an important role in preventing and detecting fraud and protecting the organisation's resources, both physical (i.e. machinery and property) and intangible (i.e. reputation or intellectual property such as trademarks).

An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of the Company that, taken together.

- Facilitates its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieve the Company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed;
- Helps to ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organization;

- Helps ensure compliance with applicable laws and regulations, and also internal policies with respect to conducting business.

Answer 2(a)(iii)**Risk Management Process**

Risk management is a structured, consistent and continuous process, applied across the organisation for the identification and assessment of risks, control assessment and exposure monitoring.

The objectives of the Company's risk management framework comprise the following:

- To identify, assess, prioritize and manage existing as well as new risks in a planned and coordinated manner.
- To increase the effectiveness of internal and external reporting structure.
- To develop a risk culture that encourages employees to identify risks and associated opportunities and respond to them with appropriate actions.

All companies have express or implied objectives which ultimately contribute to the maximization of shareholder value. Risk management actively supports the achievement of those objectives. It is not a process for avoiding risk. Properly implemented risk management can actively allow a company to undertake activities that have a higher level of risk thereby achieving a greater benefit because risks have been identified, understood and well managed.

Organizations which do have risk management policies in place are rewarded by added premium in the market and shall be better placed to pursue objectives and opportunities with confidence.

Risk management can be seen as a tool for creating opportunities for the businesses as they develop during the risk management process. Moreover such opportunities arise also from the complementary effect of risk management with other business planning process.

In other words, risk management is not just about preventing risks, but also managing it properly. However, managing risks properly does not mean becoming risk averse, or ignoring new opportunities for being "too risky".

Risk management provides a framework to:

- ensure that all the foreseeable risks involved are actually understood and accepted before important decisions are taken.
- monitor new projects, and ongoing operations, to ensure that they continue to develop satisfactorily, and no problems or new risks emerge.

It is pertinent to note that every activity carries a potential reward as well. Risk management, essentially, is about managing risk against reward.

Answer 2(b)

A corporate blog is a blog published by or with the support of an organization to reach the organizations goals. The word blog is derived from the word weblog wherein regular entries of commentary description of events are published. Corporate blog is

used by an organization to reach its organizational goals. The advantage of the blogs is that posts and comments are easy to reach and follow due to centralized hosting and generally structured conversation threads. Corporate blog is very popular as economical, effective, has wide coverage, is expedient and cost effective. As a marketing and public relations tool, its value is immense.

Vertical communication on the other hand, focuses the internal targets alone like employees. It is management tool though its public relations value is equally important. Moreover, it consists mainly by instructions, orders, task points, company's image-material and internal newsletter type communication.

Question 3

- (a) *What is 'corporate philanthropy' ? How is it different from corporate social responsibility (CSR) ?* (7 marks)
- (b) *Describe the responsibilities of the Board of directors towards company, management, stakeholders and government.* (8 marks)

Answer 3(a)

Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

The Etymological origin of the word is from Late Latin philanthropia, from Greek philanthropia, from philanthropos loving people that is phil- + anthropos human being. It is the active effort to promote human welfare.

Corporate Social Responsibility on the other hand is about how a company align their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/ or planet issues. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which drives the CSR initiatives in companies.

Answer 3(b)

Responsibilities of Board of Directors

Responsibilities cast upon Directors are quite onerous and multifarious. Directors are in fiduciary position and must exercise their powers for the benefit of the company. Board is responsible for direction, control and supervision of the management of the company's affairs. They have to establish effective corporate governance procedures and best practices. Ultimate control and management vests with the Board.

Responsibilities towards the company

The board should ensure that:

- It acts in the best interest of the company.

- The decisions it takes does not serve the personal interests of its members.
- It helps the company in increasing its profits and turnover by following principles of equity, ethics and values.
- It helps the company in building its goodwill.
- It shares with the management the decision taken by them and the reasons thereof.
- That the company has systems and means to best utilize the resources of the company and especially its intangible resources.

Responsibilities towards management

The board must ensure that:

- It gives its guidance, support and direction to the management in every decision.
- It acts as leader to inspire and motivate the management to perform their duties.
- It encourages leadership development.
- It encourages compliance and disclosures.
- It trusts the management and gives it the freedom to act.
- It does not dictate terms but take objective decisions.
- It follows the company's code of conduct and the other rules and the regulations of the company.

Responsibilities towards stakeholders

The board must ensure that:

- Its every decision helps in the increasing the stakeholders value.
- It does not act in a manner by which any stakeholder is prejudiced.
- One stakeholder should not be benefited at the cost of the other.
- It must discourage restrictive or monopolistic activities for the undue benefit of the company.
- That proper system is established and followed which helps in resolving the grievances of the stakeholders.
- That company has policies for different class of stakeholders which are equally applicable. Such policies should be based on the principles of equity and justice.
- That company discloses its policies to all the stakeholders.
- The stakeholders are able to establish long term relationships based on trust and confidence.

Responsibility towards government

The board must ensure that:

- The company complies with all the laws applicable to it whether they are the central laws or state laws.
- There are systems and checks to ensure that the above is complied.
- That all the dues towards the government in the form of taxes, rates, etc. are paid on time.
- It supports the initiatives taken by the government for the promotion of welfare and security of the nation.

Question 4

- (a) *“A positive synergy out of due integration of the social responsibility of business with the commercial focus is on the whole a fairy tale with catchy gains.”*
Elucidate. (7 marks)
- (b) *Enumerate various committees of the Board of directors which are required to be constituted under clause 49 of the listing agreement and state their functions?*
 (8 marks)

Answer 4(a)

The integration of the CSR initiatives of a company with its commercial purpose does give rise to positive synergies. The positive synergies of CSR include:

- a. CSR creates a favorable public image
- b. The positive image created out of CSR promotes goodwill and loyalty of the stakeholders including employees
- c. Society gains in the form of better neighborhood and employment opportunities.
- d. Satisfaction of changed consumer needs and expectations
- e. Social involvement reduces the need for legal and governmental interference
- f. External environment is also improved
- g. Good CSR ensures due balance of authority (financial power) and responsibility
- h. It has exemplary impact on other units too
- i. Encourages cooperative/positive attitudes
- j. Project assessments are made in terms of social cost-benefits too.
- k. CSR alone is suitable for promoting national and public interest and economic growth with welfare.

The synergy between the social involvement of business into its basic commercial-profit-gain focus arises due to the following reasons :

- Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains — is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.
- Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now regularly draw attention through their websites to business practices they view as problematic.
- Consumers and investors are showing increasing interest in supporting responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.
- Numerous serious and high-profile breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards.
- Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.
- There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that corporate social responsibility addresses.
- Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

Answer 4(b)**Various Committees of the Board which are required to be constituted under Clause 49**

Audit Committee and Shareholders Grievance Committees are mandatory committees which have to be constituted by a listed entity to whom clause 49 of the Listing Agreement is applicable.

Audit Committee

A key element in the corporate governance process of any organization is its audit committee. The battle for financial statement integrity and reliability depends on balancing the pressures of multiple stakeholders, including management, regulators, investors and the public interest.

Functions of Audit Committee

The functions of the audit committee include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval. :
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval
6. Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any areas of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower mechanism, in case the same is existing.

The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
3. Management letters / letters of internal control weaknesses issued by the statutory auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Shareholders Grievance Committee/Investor Grievance Committee

In terms of Clause 49-IV(G)(iii) of the Listing Agreement, a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of

balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

The number of meetings of the Shareholders/Investors Grievance Committee should be in accordance with the exigencies of business requirements

To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the Registrar and Share Transfer Agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight

PART B

(Answer ANY TWO questions from this part.)

Question 5

- (a) Explain the concept of 'business ethics'. (2 marks)*
- (b) State the essential features of a good business ethics programme. (3 marks)*
- (c) You are the Company Secretary of Satyadhan Services Ltd. The company is currently facing crisis of sagging public image. The Board wants to publicise its ethical programme which takes care of the public aspirations. Draft a catchy 8-Point 'Good Ethics Programme' (GEP) for consideration of the Board of directors. (10 marks)*

Answer 5(a)

The Concept of Business Ethics

Business ethics is a form of applied ethics. In broad sense ethics in business is simply the application moral or ethical norms to business. The term ethics has its origin from the Greek word "ethos", which means character or custom - the distinguishing character, sentiment, moral nature, or guiding beliefs of a person, group, or institution. The synonyms of ethics as per Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct, standards.

Business ethics comprises the principles and standards that guide behaviour in the conduct of business. Businesses must balance their desire to maximize profits against the needs of the stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of businesses, rules – articulated and implicit, are developed to guide the businesses to earn profits without harming individuals or society as a whole.

Answer 5(b)

Features of Good Ethics Programme

The following factors indicate the success of an ethics programme:

- *Leadership* : that executives and supervisors care about ethics and values as much as they do about the bottom line.
- *Consistency between words and actions* : that top management "practises what it preaches".

- *Fairness* : that it operates fairly.
- *Openness* : that people talk openly about ethics and values, and that ethics and values are integrated into business decision-making.
- *Just rewards* : that ethical behaviour is rewarded.
- *Value-driven* : that an ethics and compliance programme is values-driven.

Answer 5(c)

Note for the Board

Placed below is a draft ethics programme of Sathyadhan Services Limited

Ethics Programme of Sathyadhan Services Limited

- Codes of ethics have been developed for :
 - Board and Senior Management,
 - employees,
 - vendors & contractors;
- Constitution of a Committee of the Board to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Adequate training of the Code of ethics to all whom the code would apply.
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Expression by senior management that all known ethics breaches have been reported, investigated, and resolved;
- Disclosure of practices and processes the company has adopted to promote ethical behavior.
- Re-iteration that the Code of ethics as communicated and illustrated to through the training is sacrosanct and would apply in every situation and any deviation would be strictly dealt with.

Question 6

- (a) *"Ethics is the first line of defence against corruption, while law enforcement is remedial and reactive. However, both fail to achieve the desired aim in the Indian set-up." Do you agree ? Give reasons in support of your answer.*
(7 marks)
- (b) *Explain and distinguish between 'activity analysis' and 'stakeholders analysis'.*
(8 marks)

Answer 6(a)

It is absolutely correct to say that ethics is the first line of defense against corruption. What prevents corruption in the first place is ethics. The enforcement of law is a reaction to the occurrence of the corruption. While the law can only lay down the dos and don'ts

and the consequences of doing or not doing something, the compliance to law in letter & spirit can be achieved only through ethical practices being followed.

An act may be perfectly legal but totally unethical. Therefore, the statement law enforcement is remedial and reactive is also true.

However, ethics is not absolute and is open to the influence of time, place and situation. Certain unethical practices on account of the fact that it is widely prevalent is apparently justified.

The following are some of the factors that have contributed to the prevalence of corruption in India :

- (i) Cultural ethos : Putting a premium on materialism, profiteering, power-play and casual attitude for ethical values..Myopic concerns over-riding long-term considerations and values.
- (ii) Institutional failures : procedural rigmaroles, in-built obstacles, bureaucratic red-tapism etc.
- (iii) Poor enforcement of law : delays in justice.
- (iv) Erosion of values in politicians, entrepreneurs; political lobbying etc.

Answer 6(b)

Stakeholder Analysis

Stakeholder analysis is the identification of a project's/activity's key stakeholders, an assessment of their interests, and the ways in which these interests affect project riskiness and viability. It is linked to both institutional appraisal and social analysis: drawing on the information deriving from these approaches, but also contributing to the combining of such data in a single framework. Stakeholder analysis contributes to project design/activity design through the logical framework, and by helping to identify appropriate forms of stakeholder participation.

Doing a stakeholder analysis can:

- draw out the interests of stakeholders in relation to the problems which the project is seeking to address (at the identification stage) or the purpose of the project (once it has started).
- identify conflicts of interests between stakeholders,
- help to identify relations between stakeholders which can be built upon, and may enable establish synergies
- help to assess the appropriate type of participation by different stakeholders.

The underlining factor in the stakeholder concept is that every activity of an organization should be based taking into account the interests of all the stakeholders. A holistic approach ensuring fairness to all the stakeholders is completely necessary for the sustainability of an enterprise.

A major reason for increasing adoption of a Stakeholder Concept in setting business

objectives is the recognition that businesses are affected by the "environment" in which they operate. Businesses come into regular contact with customers, suppliers, government agencies, families of employees, special interest groups. Decisions made by a business are likely to affect one or more of these "stakeholder groups".

The stakeholder concept suggests that the managers of a business should take into account their responsibilities to other groups - not just the shareholder group - when making decisions. The concept suggests that businesses can benefit significantly from cooperating with stakeholder groups, incorporating their needs in the decision-making process.

Activity Analysis

The ethical dimension of an activity can be determined with the help of the following grid which is self-explanatory:

Activity Analysis

(Ethical)

Parasite 1 Helping self Injuring Others	Win-win Situation 3 Helping self Helping Others
Martyr 2 Helping Others Injuring self	Total Loss 4 Injuring self Injuring Others

The first block in the grid – help self and injuring others is obviously unethical. The second block that is helping others and injuring self may appear to be ethical, however it is not ethical. The third grid wherein one helps self and also helps others is the most ideal and ethical situation. The win-win situation. The last grid is a situation that should be avoided at all costs and is highly unethical.

Question 7

(a) Outline the main provisions of a 'model code of business conduct and ethics'.
(7 marks)

(b) Write short notes on any two of the following :

(i) Ethics audit

(ii) Ethical dilemma

(iii) Deontological ethics.

(4 marks each)

Answer 7(a)

The Code should include the following:

(a) Company Values.

(b) Avoidance of conflict of interest.

- (c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company's other communications.
- (d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations.
- (e) Maintaining confidentiality of Company affairs.
- (f) Non-competition with Company and maintaining fair dealings with the Company.
- (g) Standards of business conduct for Company's customers, communities, suppliers, shareholders, competitors, employees.
- (h) Prohibition of Directors and senior management from taking corporate opportunities for themselves or their families.
- (i) Review of the adequacy of the Code annually by the Board.
- (j) No authority of waiver of the Code for anyone should be given.

The Code of Conduct for each Company summarises its philosophy of doing business.

Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

- Use of company's assets;
- Avoidance of actions involving conflict of interest;
- Avoidance of compromising on commercial relationship;
- Avoidance of unlawful agreements;
- Avoidance of offering or receiving monetary or other inducements;
- Maintenance of confidentiality;
- Collection of information from legitimate sources only.
- Safety at workplace
- Maintaining and Managing Records
- Free and Fair competition
- Disciplinary actions

Answer 7(b)(i)

Ethics Audit

Ethics Audit is an audit of all those functions & activities where deviation of the code of ethics of the conduct is most likely to occur. The following are the some of the suggested steps in ethics audit :

1. The first step in conducting an audit is securing the commitment of the firm's top management.

2. The second step is establishing a committee or team to oversee the audit process.
3. The third step is establishing the scope of the audit.
4. The fourth step should include a review of the firm's mission values, goals, and policies.
5. The fifth step is identifying the tools or methods that can be employed to measure the firm's progress and then collecting and analyzing the relevant information.
6. The sixth step is having the results of the data analysis verified by an independent party.
7. The final step in the audit process is reporting the audit findings to the board of directors and top executives and, if approved, to external stakeholders.

Answer 7(b)(ii)**Ethical Dilemma**

Dilemma is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive.

By definition, an ethical dilemma involves the need to choose from among two or more morally acceptable courses of action, when one choice prevents selecting the other; or, the need to choose between equally unacceptable alternatives (Hamric, Spross, and Hanson, 2000).

A dilemma could be a right vs. wrong situation in which the right would be more difficult to pursue and wrong would be more convenient. A right versus wrong dilemma is easier to resolve.

An ethical dilemma is a situation that will often involve an apparent conflict between moral imperatives, in which to obey one would result in transgressing another. This is also called an ethical paradox.

An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing to do. Ethical dilemmas make individuals think about their obligations, duties or responsibilities. These dilemmas can be highly complex and difficult to resolve. Easier dilemmas involve a 'right' versus 'wrong' answer; whereas, complex ethical dilemmas involve a decision between right and right.

Answer 7(b)(iii)

Deontological ethics is an approach to ethics that holds that acts are inherently good or evil, regardless of the consequences of the acts. A central theme among deontological theorists is that we have a duty to do those things that are inherently good ("truth-telling" for example); while the ends or consequences of our actions are important, our obligation or duty is to take the right action, even if the consequences of a given act may be bad.

It is sometimes described as "duty" or "obligation" based ethics, because deontologists believe that ethical rules "bind you to your duty."

PART C**Question 8**

Attempt any four of the following :

- (a) *Explain the concept of 'triple bottom line' (TBL). (5 marks)*
- (b) *What do you understand by 'corporate sustainability' ? State the key drivers which need to be garnered to ensure sustainability. (5 marks)*
- (c) *Explain the benefits of sustainability reporting. Describe sustainability reporting in emerging economies. (5 marks)*
- (d) *Write a note on — World Commission on Environment and Development (WCED). (5 marks)*
- (e) *Choose the most appropriate answer from the given options in respect of the following :*
 - (i) *The UN climate change conference was held in Bali, Indonesia in —*
 - (a) *January, 2005*
 - (b) *June, 2000*
 - (c) *December, 2007*
 - (d) *January, 2009.*
 - (ii) *The International Labour Organisation (ILO) was created by a treaty in —*
 - (a) *Rome*
 - (b) *Versailles*
 - (c) *Paris*
 - (d) *Geneva.*
 - (iii) *The Biodiversity Treaty has —*
 - (a) *Two goals*
 - (b) *Four goals*
 - (c) *Only one goal*
 - (d) *Three goals.*
 - (iv) *The rule in Rylands vs. Fletcher originally applies only to —*
 - (a) *Natural resources*
 - (b) *Industrial disasters*
 - (c) *Agrarian water logging*
 - (d) *Dangerous industries.*
 - (v) *The Corporate Manslaughter and Corporate Homicide Act, 2007 applies to industries located in —*
 - (a) *India*
 - (b) *UK*

- (c) USA
- (d) France. (1 mark each)
- (f) State, with reasons in brief, whether the following statements are correct or incorrect:
- (i) Sustainable development and economic growth are co-terminous.
 - (ii) In real life, many public limited companies do not exist in perpetuity.
 - (iii) Stakeholders identification is optional as per the global reporting initiative.
 - (iv) Agenda-21 was adopted at the Earth Summit in New York in 1992 by way of a treaty.
 - (v) There is an absolute and non-delegatable duty on an enterprise which is engaged in a hazardous or inherently dangerous activity. (1 mark each)

Answer 8(a)

Triple Bottom Line (TBL)

In 1999 Elkington developed the concept of the Triple Bottom Line which proposed that business goals were inseparable from the societies and environments within which they operate. Whilst short-term economic gain could be chased, a failure to account for social and environmental impacts would make those business practices unsustainable.

The Triple Bottom Line is made up of "Social, Economic and Environmental" aspect and indicated by the phrase "People, Planet, Profit".

"People" means Human Capital. It implies fair and beneficial business practices toward labour and the community and region in which a corporation conducts its business would create long term value. Well being of a corporate, its labour and other stakeholder interests are interdependent. For example, fair pay to workforce, health and safety at work place, tolerable working hours etc.

The second aspect of TBL is "Planet" - the Natural Capital. It refers to sustainable environmental practices. A company which decides to follow TBL always keep in mind that it does no harm nature or create negative environmental impact.

The third aspect of triple bottom line is profit. The concept of profit for TBL company is somehow more wider in all perspective. It is the reflection of economic impact the organization has on its business activities and that too after meeting all social and environmental cost. It somehow indicates real value addition a corporate made through its various activities.

World wide many corporates are now adopting Triple Bottom Line under vision and mission and practicing the same through aligning their corporate policies in that direction.

Many countries worldwide are now contemplating how to integrate this triple bottom line under their legal system.

Answer 8(b)

Corporate sustainability indicates new philosophy as an alternative to the traditional growth and profit-maximization model under which sustainable development comprising

environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous corporate growth and profitability.

It is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations.

Corporate sustainability encompasses strategies and practices that aim to meet the needs of stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future. Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.

Concern towards social, environmental and economical issues, i.e., covering all the segments of stakeholders, are now basic and fundamental issues which permits a corporate to operate in long run sustainably. Following key drivers need to be garnered to ensure sustainability

- *Internal capacity building strength* – In order to convert various risks into competitive advantage.
- *Social impact assessment* – In order to become sensitive to various social factors, like changes in culture, living habits etc.
- *Repositioning capability* through development and innovation Crystallization of all activities to ensure consistent growth

Corporate sustainability is a business approach creating shareholder value in long run.

Answer 8(c)

Benefits of Sustainability Reporting

Benefits of sustainability reporting are:

- Legitimation of corporate activities, products and services which create environmental and social impacts.
- Increase in corporate reputation and brand value.
- Gaining a competitive advantage.
- Comparison and benchmarking against competitors.
- Increasing transparency and accountability within the company.
- Establishing and supporting employee motivation as well as internal information and control processes.

Sustainability Reporting in Emerging Economies

Investors increasingly recognize the value of robust sustainability reporting and expectations for such reporting have spread to companies in emerging markets. While it may be difficult for emerging market companies to devote the resources to such reporting,

companies should begin by taking the first step of committing to the process of reporting, and demonstrating that they are managing the sustainability issues most material to their sector. Such companies would develop a competitive advantage in the marketplace and reach a greater range of investors and customers.

Increasingly global companies understand that a commitment to sustainability reporting can contribute to financial success. Such transparency allows companies to reach a broader range of investors and customers, enhance operational efficiency, improve brand positioning, and develop leadership in the marketplace.

Recently, in India, Corporate Environmental Reporting as a useful adjunct to the concept sustainable development, has been recognized in various policy documents like the Approach Paper to the Eleventh Plan and the National Environmental Policy 2006.

Answer 8(d)

The Brundtland Commission, formally the World Commission on Environment and Development (WCED), known by the name of its Chair Gro Harlem Brundtland, was convened by the United Nations in 1983. The Commission was created to address growing concern “about the accelerating deterioration of the human environment and natural resources and the consequences of that deterioration for economic and social development.” In establishing the Commission, the UN General Assembly recognized that environmental problems were global in nature and determined that it was in the common interest of all nations to establish policies for sustainable development.

The Report of the Brundtland Commission, *Our Common Future*, published in 1987, dealt with sustainable development and the change of policies needed for achieving that. The definition of this term in the report is quite well known and often cited:

“Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

Answer 8(e)(i)

- (c) December, 2007

Answer 8(e)(ii)

- (b) Versailles

Answer 8(e)(iii)

- (d) Three goals

Answer 8(e)(iv)

- (c) Agrarian water logging

Answer 8(e)(v)

- (b) UK

Answer 8(f)(i)*Correct*

Sustainable development balances the need for economic growth with environmental protection and social equity.

Answer 8(f)(ii)*Correct*

Many times corporates become non-functional and reach a closure situation.

Answer 8(f)(iii)*Incorrect*

The reporting organization should identify its stakeholders and explain in its report how it has responded to their reasonable expectations and interests.

Answer 8(f)(iv)*Incorrect*

It was adopted at Rio De Janeiro and not New York.

Answer 8(f)(v)*Correct*

An enterprise owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone on account of hazardous or inherently dangerous nature of the activity which it has undertaken.

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

Answer Question No. 1 which is compulsory
and any two of the rest from this part.

Question 1

- (a) *In United Kingdom, the Combined Code on Corporate Governance of 2008 is the result of studies made from time to time by various committees to prevent the recurrence of scandals and financial collapses experienced in 1980s and early 1990s, when Cadbury Committee was first set-up in 1992 which gave a new dimension to the Corporate Governance.*

List out the three important recommendations made by Cadbury Committee and outline atleast five major landmarks in the historical development since the setting-up of the Cadbury Committee for improvement in the Corporate Governance. (10 marks)

- (b) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *All non-executive directors are independent directors.*
 - (ii) *Compliance Management Committee is compulsory under clause 49 of the listing agreement.*
 - (iii) *The Sarbanes-Oxley Act, 2002 is applicable to listed companies in India.*
 - (iv) *Enron debacle led to the appointment of Naresh Chandra Committee in 2002.*
 - (v) *Shareholders activism played a major role in eradicating apartheid in South Africa through divestment. (1 mark each)*
- (c) *Choose the most appropriate answer from the given options in respect of the following :*
- (i) *The mechanism for employees to report certain events to the management, like—unethical behaviour, suspected fraud or violation of the company's code, is known as —*
 - (a) *Whistle Blower Policy*
 - (b) *Surveillance action*
 - (c) *Market abuse*
 - (d) *Snap investigation.*
 - (ii) *Out of the following, which is an institutional investor group —*
 - (a) *Foreign Institutional Investors*
 - (b) *Mutual funds*
 - (c) *Banks and financial institutions*
 - (d) *All the above.*

- (iii) *Out of the following, which is a Corporate Social Responsibility (CSR) reporting framework —*
- (a) *CSR 1982*
 - (b) *SA 8000*
 - (c) *MCA-21*
 - (d) *SA 800.*
- (iv) *A person can hold office of director of the public companies at the same time in —*
- (a) *Not more than 20 companies*
 - (b) *Not more than 11 companies*
 - (c) *Not more than 15 companies*
 - (d) *Any number of companies.*
- (v) *Remuneration Committee is appointed for the purpose of recommending remuneration of —*
- (a) *Chief Executive Officer*
 - (b) *Managing Director*
 - (c) *Whole-time Director*
 - (d) *All the above.*
- (1 mark each)*

Answer 1(a)

Historical developments in the UK for the improvement in corporate governance since the setting of Cadbury Committee are as under:

- (i) The Cadbury Report 1992;
- (ii) The Greenbury Report, 1995;
- (iii) The Hampel Report 1998
- (iv) The Turnbull Report;
- (v) Higgs Report
- (vi) Smith Report;
- (vii) The Tyson Report
- (viii) The combined code on Corporate Governance as revised in 2003;
- (ix) The combined Code of Corporate Governance, 2006, and;
- (x) The combined Code on Corporate Governance 2008;
- (i) *The Cadbury Report 1992*

Due to several scandals and financial collapses in the UK in the late 1980s and early 1990s, London Stock Exchange set up the Cadbury Committee in May 1991 to raise the standard of corporate governance for preventing such scandals

and financial collapses in future. This Committee, in its report known as 'Cadbury Report, recommended mainly :

- Separating the role of CEO and Chairman of the Board
- Balanced composition of Board of Directors with executive and non-executive directors.
- Selection process for non-executive directors.

(ii) *The Greenbury Report 1995*

The Confederation of British Industry set up a group under the Chairmanship of Sir Richard Greenbury to examine the remuneration of the directors. It recommended the formation of Remuneration Committee composed of non-executive directors. Its recommendations were incorporated in the Listing Rules of the London Stock Exchange.

(iii) *The Hampel Report 1998*

The Hampel Committee was set up to review the implementation of Cadbury and Greenbury Reports and to see that their purposes were being achieved. The recommendations of this committee coupled with further consultations by the London Stock Exchange resulted in a Combined Code on Corporate Governance – the original Combined Code, 1998.

(iv) *The Turnbull Report*

A working group under the chairmanship of Nigel Turnbull recommended the Internal Control Guidance for Directors which were included in the combined code.

(v) *Higgs Report*

The Combined Code was reviewed in July 2002 by Derek Higgs about the role and effectiveness of non-executive directors.

(vi) *Smith Report*

A group under the chairmanship of Sir Robert Smith was set up to develop Guidance for Audit Committee in the Combined Code.

(vii) *The Tyson Report*

The Tyson Report was commissioned on the recruitment and development of non-executive directors.

(viii) *The Combined Code on Corporate Governance as revised in 2003*

On the basis of recommendations of all the reports the Combined Code was revised in 2003

(ix) *The Combined Code on Corporate Governance 2006*

The Combined Code on Corporate Governance was again revised in 2006.

(x) *The Combined Code on Corporate Governance 2008*

The Combined Code on Corporate Governance 2008 sets out standards of good practice in relation with shareholders. All companies incorporated in the UK and listed on the London Stock Exchange are required to report in their annual reports and accounts about the implementation of the combined code on Corporate Governance .

Answer 1(b)(i)

Incorrect

Non-executive directors may or may not be independent directors

Answer 1(b)(ii)

Incorrect

Corporate Compliance Committee is not amongst the mandatory committees which have to be constituted by a listed entity to which clause 49 of the Listing Agreement is applicable. The mandatory committees are, Audit Committee and Shareholders Grievance Committee.

Answer 1(b)(iii)

Incorrect

This Act was passed in the United States and is applicable to companies listed in the US.

Answer 1(b)(iv)

Correct

The Enron debacle of 2001 involving the hand-in-glove relationship between the auditor and the corporate client, the scams involving the fall of the corporate giants were some important factors which led the Indian Government to wake up and in the year 2002, Naresh Chandra Committee was appointed to examine and recommend inter alia amendments to the law involving the auditor-client relationships and the role of independent directors.

Answer 1(b)(v)

Correct

Shareholder activism played a major role in eradicating apartheid in South Africa through divestment.

Answer 1(c)(i)

- (a) Whistle Blower Policy.

Answer 1(c)(ii)

- (d) All the above.

Answer 1(c)(iii)

- (b) SA 8000.

Answer 1(c)(iv)

- (c) Not more than 15 companies.

Answer 1(c)(v)

- (d) All the above.

Question 2

- (a) Write short notes on the following :

(i) Rules vs. principles

(ii) Parties to corporate governance.

(3 marks each)

- (b) Expand the following abbreviations :

(i) OECD

(ii) NFCG

(iii) COSO

(iv) ASSOCHAM.

(1 mark each)

- (c) Draw a comparison between section 292A of the Companies Act, 1956 and clause 49 of the listing agreement with regard to composition of the audit committee.

(5 marks)

Answer 2(a)(i)**Rules v. Principles**

Rules are written prescriptions for conduct or action and are absolute. Principles, on the other hand, provides a guidance of acceptable actions that are fair and equitable.

Under rules-based governance, companies must comply with a specific set of procedural requirements, a checklist of what to do and what not to do. Under a principles-based regime, however, corporate behavior is guided by a focus on end results. This approach emphasizes “doing the right thing,” by whatever means the company’s leadership feels most appropriate.

Rules are typically thought to be simpler to follow than principles, demarcating a clear line between acceptable and unacceptable behaviour. Rules also reduce discretion on the part of individual manager or auditors.

Hon’ble Supreme Court of India in a case of Bajaj Auto Limited, defined the discretion as proper adoption of the rules.

In practice rules can be more complex than principles. They may be ill equipped to deal with new types of transaction not covered by the Code. Moreover, where clear rules are followed one can still find a way to circumvent their underlying purpose. This is harder to achieve if one is bound by broader principles.

Principles are a form of self regulation. They allow the respective sector to determine what standards are acceptable or unacceptable. It also pre-empts over zealous legislations that might not be practical.

Answer 2(a)(ii)**Parties to corporate governance**

The Board of Directors play a central role in ensuring good governance in a corporate. In a business context, those who have a “stake” or claim in some aspect of a company’s products, operations, markets, industry, and outcomes are known as stakeholders. The various stakeholders of a corporate are all parties to corporate governance. The stakeholders of a corporate include its employees, shareholders, suppliers, vendors, customers, creditors, regulators, government/s and the community at large. These groups are influenced by business, and they also have the ability to affect the business.

Answer 2(b)(i)

OECD – Organisation for Economic Co-operation and Development.

Answer 2(b)(ii)

NFCG – National Foundation for Corporate Governance.

Answer 2(b)(iii)

COSO – Committee of Sponsoring Organization of the Tread way Commission.

Answer 2(b)(iv)

ASSOCHAM – Associated Chambers of Commerce and Industry.

Answer 2(c)**Comparison between Clause 49 and Section 292A of the Companies Act, 1956**

<i>Requirements of Clause 49</i>	<i>Requirements of Section 292A of Companies Act</i>
Applicable to all listed companies with paid-up capital of more than Rs.3 Cr or Networth greater than Rs. 25 Cr at any time in the history of the company and to companies seeking listing	Applicable to public companies with paid-up capital greater than Rs.5 Cr
2/3rd of the directors shall be independent directors	Members shall be other than managing or whole-time directors i.e. members shall be non-executive directors.
All members shall be financially literate and at least one member shall have accounting expertise	No corresponding requirement
“independent” director can be Chairman	Any member of Audit Committee can be Chairman
Auditors, internal auditor & director-finance or other executives may be present as invitees	Auditors, internal auditor & the director-finance shall attend & participate at meetings of Audit Committee but shall not vote
Company secretary to be secretary of the Audit Committee	No corresponding requirement

Question 3

- (a) *What are the major legislations/regulations/guidelines dealing with transparency and disclosures by companies ?* (5 marks)
- (b) *Discuss in brief some of the main Corporate Social Responsibility (CSR) Reporting Frameworks.* (5 marks)
- (c) *What is 'risk management process' ? What are the four steps in risk management?* (5 marks)

Answer 3(a)

The following are some of the major legislations on transparency and disclosure:

1. Companies Act, 1956

In terms of Companies Act, 1956 the aspect of disclosure and transparency spans over several sections. Some of the major disclosures contemplated in terms of Companies Act include the Balance sheet, profit and loss account, Board's Report, Auditor's Report, Annual Return and the various filings with ROC.

With the e-filing of forms with the Registrar of Companies, The Ministry of Corporate Affairs has put in place a mechanism that is imaginative, technologically savvy and stakeholder friendly. Through the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance, the MCA aims at moving from paper based to nearly paperless environment.

- 2. Listing Agreement In terms of the Listing Agreement several clauses deal with disclosure. The following are some of the clauses dealing with disclosure – Clauses 19, 22, 29, 30, 31, 32, 35, 36, 41. Clause 49 of the listing agreement deals with Corporate Governance and mandates various disclosures like remuneration to directors, directors' attendance in board, committee and Annual General Meetings, Management Discussion and Analysis Report, etc.
- 3. (Erstwhile) SEBI (DIP) Guidelines 2000 (now Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- 4. SEBI (SAST) Regulations, 1997.
- 5. SEBI (Prohibition of Insider Trading) Regulations, 2002.
- 6. Securities Contract (Regulations) Act, 1956.

Answer 3(b)

The following are some of the main standards for social, ethical and environmental reporting currently in use internationally:

The AA 1000 - framework developed by the Institute of Social and Ethical Accountability provides a standard for social and ethical accounting, auditing and reporting, including mandatory external verification and stakeholder engagement.

The Social Accountability - SA 8000 is an international standard for social accountability initiated by Council on Economic Priority Accreditation Agency (CEPAA) conventions, the Universal Declaration on human rights and the Child. SA 8000 seeks to provide transparent, measurable and verifiable performance standards in the areas of child labour; forced labour; health and safety; compensation; working hours; discrimination; discipline; free association and collective bargaining; and management systems.

The Good Corporation - global standard of corporate social responsibility developed by the Institute of Business Ethics. This covers fairness to employees, suppliers, customers and providers of finance; contributions to the community; and protection of the environment. Company performance is assessed annually by an independent verifier.

The UN Global Compact

The Global Compact is a voluntary corporate citizenship initiative with two objectives:

“Making the Global Compact and its principles part of business strategy and operations.”

“Facilitating cooperation among key stakeholders and promoting partnerships in support of U.N. goals.”

The Global Compact's ten principles in the areas of human rights, labour, the environment and anti-corruption.

The OECD Guidelines for Multinational enterprises - set out recommendations for responsible business conduct in employment and industrial relations; human rights; the environment; information disclosure; competition; taxation; science and technology; combating bribery; and protection of consumer interests. They are not legally binding and there is no requirement for reporting or external measurement. (www.oecd.org/daf/investment/guidelines)

Answer 3(c)

Risk Management Process

Risk management is a structured, consistent and continuous process, applied across the organisation for the identification and assessment of risks, control assessment and exposure monitoring.

The objectives of the Company's risk management framework comprises the following:

- To identify, assess, prioritize and manage existing as well as new risks in a planned and coordinated manner.
- To increase the effectiveness of internal and external reporting structure.
- To develop a risk culture that encourages employees to identify risks and associated opportunities and respond to them with appropriate actions.

Steps in Risk Management

The process of risk management consists of four logical and sequential steps as under:

- (i) Identification of risk.
- (ii) Evaluation/measurement of risks.
- (iii) Handling of risks.
- (iv) Implementation of risk management decisions.

Question 4

(a) *What are the legal remedies available in India for the redressal of the following complaints :*

- (i) *Delay in refund of application money;*
- (ii) *Delay in transfer of securities;*
- (iii) *Insider trading of shares;*
- (iv) *Delay in payment of dividend; and*
- (v) *Delay in re-payment of deposits.*

(5 marks)

(b) *Discuss briefly the role of directors in the good corporate governance.*

(5 marks)

(c) *What are the principles of corporate governance as evolved by the ICSI ?*

(5 marks)

Answer 4(a)(i)**Delay in refund of excess application money or allotment letters**

Section 73 of the Companies Act, 1956 provides for payment of interest for the period beyond 70 days from the closure of subscription list @ 15 percent

Answer 4(a)(ii)**Delay in Transfer of Shares**

Section 113 of the Companies Act, 1956 provides a time limit of 60 days provided for effecting transfer. If default is made every officer of the company who is in default shall be liable to fine which may extend to Rs.5000 for every day during which the default continues.

As per listing agreement the time limit is 30 days.

Answer 4(a)(iii)

Insider Trading, rigging and other mal practices

Investors can make complaints to SEBI for the violation of SEBI (Prohibition of Insider Trading) Regulations, 1992

Answer 4(a)(iv)

Section 207 of the Companies Act, 1956 casts an obligation on the company to pay dividend within 30 days from its declaration. In case of default every director who is party to the default is punishable with imprisonment and fine of Rs.1000/- for each day the default continues.

Answer 4(a)(v)

In terms of Section 58A (9) of the Companies Act, 1956 where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of its acceptance, the Company Law Board may on its own motion or an application by a depositor direct the company to make the repayment of the deposit.

In terms of Section 58AAA any offence arising out of acceptance of deposit is a cognizable offence under Code of Criminal Procedure 1973.

Answer 4(b)

The Board of Directors play a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. The responsibilities of the directors and the Board derive from law, custom, tradition and current practice. In the present times, transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalization are some of the concerns that the Boards interlocks. The Boards today have to respond to the explosive demands of the marketplace. The contribution of directors on the Board of companies is critical for ensuring appropriate directions with regard to leadership, vision, strategy, policies, monitoring, supervision, accountability to shareholders and other stakeholders, and to achieving greater levels of performance on a sustained basis as well as adherence to the best practices of corporate governance.

Directors have the ultimate responsibility for the longer-term prosperity of the company. They are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly, directors may be made personally liable in both civil and criminal law.

Directors are accountable to the shareholders for the company's performance and can be removed from office by them or the shareholders can pass a special resolution requiring the Directors to act in a particular way. Directors act as "Fiduciaries" of the shareholders and should act in their best interests but also taking into account the best interests of the company as a whole (as a separate legal entity) and the other stakeholders.

Directors have a key role in the determination of the value and ethical position of the company.

Answer 4(c)

The principles of corporate governance evolved by the ICSI are as under:

- Sustainable development of all stakeholders – to ensure growth of all individuals associated with or affected by the enterprise on sustainable basis.
- Effective management and distribution of wealth – to ensure that enterprise creates maximum wealth and judiciously uses the wealth so created for providing

maximum benefits to all stakeholders and enhancing its wealth creation capabilities to maintain sustainability.

- Discharge of social responsibility – to ensure that enterprise is acceptable to the society in which it is functioning.
- Application of best management practices – to ensure excellence in functioning of enterprise and optimum creation of wealth on sustainable basis.
- Compliance of law in letter and spirit – to ensure value enhancement for all stakeholders guaranteed by the law for maintaining socio-economic balance.
- Adherence to ethical standards – to ensure integrity, transparency, independence and accountability in dealings with all stakeholders.

PART B

(Answer ANY TWO questions from this part)

Question 5

- (a) *“Ethics in business is simply the application of moral or ethical norms to business.” Explain and discuss the advantages of business ethics. (5 marks)*
- (b) *Write notes on any two of the following :*
- (i) *Enlightened-egoism*
 - (ii) *Ethics in compliance*
 - (iii) *Social and ethical accounting. (5 marks each)*

Answer 5(a)

Business ethics is a form of applied ethics. In broad sense ethics in business is simply the application moral or ethical norms to business. Ethics is a set of principles or standards of human conduct that govern the behavior of individuals or organizations. Using these ethical standards, a person or a group of persons or an organization regulate their behavior to distinguish between what is right and what is wrong as perceived by others.

The advantages of business ethics include :

1. *Attracting and retaining talent*

People aspire to join organizations that have high ethical values. Companies are able to attract the best talent and an ethical company that is dedicated to taking care of its employees will be rewarded with employees being equally dedicated in taking care of the organization. Ethical organizations create an environment that is trustworthy, making employees willing to rely, take decisions and act on the decisions and actions of the co-employees. In such a work environment, employees can expect to be treated with respect and consideration for their colleagues and superiors. It cultivates strong teamwork and productivity and support employee growth.

2. *Investor Loyalty*

Investors are concerned about ethics, social responsibility and reputation of the company in which they invest. Investors are becoming more and more aware that an ethical climate provides a foundation for efficiency, productivity and

profits. Relationship with any stakeholder, including investors, based on dependability, trust and commitment results in sustained loyalty.

3. *Customer satisfaction*

Customer satisfaction is a vital factor in successful business strategy. Repeat purchases/orders and enduring relationship of mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company that adopts ethical practices. When a company because of its belief in high ethics is perceived as such, any crisis or mishaps along the way is tolerated by the customers as a minor aberration. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified ensuring that organizational behaviors are aligned with those values. An organization with a strong ethical environment places its customers' interests as foremost. Ethical conduct towards customers builds a strong competitive position. It promotes a strong public image.

Answer 5(b)(i)

Enlightened-egoism

This model takes into account harms, benefits and rights. Therefore, under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company's providing the scholarship benefits the needy students, but ultimately it is in the company's self interest.

Answer 5(b)(ii)

Ethics in Compliance

Compliance is about obeying and adhering to rules and authority. The motivation for being compliant could be to do the right thing out of the fear of being caught rather than a desire to be abiding by the law. An ethical climate in an organisation ensures that compliance with law is fuelled by a desire to abide by the laws. Organisations that value high ethics comply with the laws not only in letter but go beyond what is stipulated or expected of them.

Answer 5(b)(iii)

Social and ethical accounting

It is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the development of policies and performance targets and to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized balance sheet or unit of currency. The issues are defined by the company's values and by the interests and expectations of its stakeholders, and societal norms and regulations.

With the focus on the concerns of society, the social and ethical accounting framework implicitly concerns itself with issues such as economic performance, working conditions, environmental and animal protection, human rights, fair trade and ethical trade, human resource management and community development, and hence with the sustainability of a company's activities.

Question 6

- (a) *What is the role of Board of directors in ethical management of a company ?*
(5 marks)
- (b) *Discuss 'ethics programme'. Set-out the relevant provisions in clause 49 of the listing agreement.*
(5 marks)
- (c) *What is the significance of organisation structure in business ethics ?*
(5 marks)

Answer 6(a)

The board of directors hold the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions. As has been stated earlier the ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. The directors on a company's board assume legal responsibility for the firm's resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology are revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company's approach towards ethical issues and stakeholder interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight of ethics programme by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

Answer 6(b)

Ethics Programme

A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate.

Two types of control systems can be created.

Compliance Orientation Programme : A compliance orientation creates order by requiring that employees identify with and commit to specific required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for non-compliance.

Values Orientation : Values Orientation strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of ideals such as respect and responsibility. Instead of relying on coercion, the company's values are seen as something to which people willingly aspire.

Most companies begin the process of establishing organizational ethics programs by developing codes of conduct. **Codes of conduct** are formal statements that describe what an organization expects of its employees

Corporate codes of conduct/ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

In India, Clause 49 of the Listing Agreement requires that

- (i) The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.
- (ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

Explanation : For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

Answer 6(c)

An organization's structure is important to the study of business ethics. In a **Centralized organization**, decision-making authority is concentrated in the hands of top-level managers, and little authority is delegated to lower levels. Responsibility, both internal and external, rests with top management. This structure is especially suited for organizations that make high-risk decisions and whose lower-level managers are not highly skilled in decision making. It is also suitable for organizations in which production processes are routine and efficiency is of primary importance.

These organizations are usually extremely bureaucratic, and the division of labour is typically very well defined. Each worker knows his or her job and what is specifically expected, and each has a clear understanding of how to carry out assigned tasks. Centralized organizations stress formal rules, policies, and procedures, backed up with elaborate control systems. Their codes of ethics may specify the techniques to be used for decision making.

Because of their top-down approach and the distance between employee and decision maker, centralized organizational structures can lead to unethical acts. If the centralized organization is very bureaucratic, some employees may behave according to “the letter of the law” rather than the spirit.

In a **decentralized organization**, decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, and coordination and control are usually informal and personal. They focus instead on increasing the flow of information. As a result, one of the main strengths of decentralized organizations is their adaptability and early recognition of external change. With greater flexibility, managers can react quickly to changes in their ethical environment. Weakness of decentralized organizations is the difficulty they have in responding quickly to changes in policy and procedures established by top management. In addition, independent profit centers within a decentralized organization may deviate from organizational objectives.

Question 7

- (a) *“The code of conduct of a company sets for the legal and ethical standards of conduct for its directors and its employees.” Discuss and list out the important contents of the code of conduct of a company. (7 marks)*
- (b) *Discuss briefly the Clarkson principles of stakeholder management. (4 marks)*
- (c) *Explain briefly the following :*
 - (i) *Virtue Ethics Theory*
 - (ii) *The Caux Round Table. (2 marks each)*

Answer 7(a)

Code of conduct or what is popularly known as Code of Business Conduct contains standards of business conduct that must guide actions of the Board and senior management of the Company.

The Code may include the following:

- (a) Company Values.
- (b) Avoidance of conflict of interest.
- (c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company’s other communications.
- (d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations.
- (e) Maintaining confidentiality of Company affairs.
- (f) Non-competition with Company and maintaining fair dealings with the Company.
- (g) Standards of business conduct for Company’s customers, communities, suppliers, shareholders, competitors, employees.
- (h) Prohibition of Directors and senior management from exploiting corporate opportunities for themselves or their families.

- (i) Review of the adequacy of the Code annually by the Board.
- (j) No authority of waiver of the Code for anyone should be given.

The Code of Conduct for each Company summarises its philosophy of doing business.

Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

- Use of company's assets;
- Avoidance of actions involving conflict of interest;
- Avoidance of compromising on commercial relationship;
- Avoidance of unlawful agreements;
- Avoidance of offering or receiving monetary or other inducements;
- Maintenance of confidentiality;
- Collection of information from legitimate sources only.
- Safety at workplace
- Maintaining and Managing Records
- Free and Fair competition
- Disciplinary actions

Answer 7(b)

The Clarkson Principle of Stakeholder Management

Max Clarkson (1922-1998) founded the Centre for Corporate Social Performance and Ethics in the Faculty of Management, now the Clarkson Centre for Business Ethics & Board Effectiveness, or CC(BE) 2. The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics :

Principle 1 : Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2 : Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3 : Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4 : Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

Principle 5 : Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6 : Managers should avoid altogether activities that might jeopardize

inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 7(c)(i)

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen the article.

Answer 7(c)(ii)

The Caux Round Table

The Caux Round Table (CRT) is based on the belief that the world business community should play an important role in improving economic and social conditions. As a statement of its aspirations, it developed a document that aims to express a world standard against which business behavior can be measured.

The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. These principles are rooted in two basic ethical ideals: *kyosei* and human dignity. The Japanese concept of “*kyosei*” means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition.

PART C

Question 8

Attempt any four of the following :

- (i) *What is the difference between ‘sustainable development’ and ‘corporate sustainability’. List out four fundamental principles of sustainable development agreed in the United Nations Conference on Environment and Development (UNCED), 1992.*
- (ii) *Discuss the significance of ‘shareholders inclusiveness’ in sustainability reporting.*
- (iii) *Write a note on ‘Agenda-21’.*
- (iv) *Discuss briefly the principle of absolute liability with the help of rule laid down in Rylands vs. Fletcher.*
- (v) *Discuss river water pollution citing at least one decision of the Supreme Court of India.* (5 marks each)

Answer 8(i)

Sustainable development is a broad concept that balances the need for economic growth with environmental protection and social equity. It is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations. Sustainable development is a broad concept and it combines economics, social justice, environmental science and management, business management, politics and law.

Corporate sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations.

It encompasses strategies and practices that aim to meet the needs of stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future.

The four fundamental Principle of Sustainable Development agreed by the United Nations Conference on Environment and Development (UNCED) are:

1. *Principle of Intergenerational equity* : need to preserve natural resources for future generation.
2. *Principle of sustainable use* : use of natural resources in a prudent manner without or with minimum tolerable impact on nature.
3. *Principle of equitable use or intergenerational equity* : Use of natural resources by any state / country must take into account its impact on other states.
4. *Principle of integration* : Environmental aspects and impacts of socio-economic activities should be integrated so that prudent use of natural resources is ensured.

Answer 8(ii)

Companies generally consider the interests of the shareholders as the foremost. However, they should take into account other stakeholders interests also.

Stakeholders are entities or individuals that can reasonably be expected to be significantly affected by the organization's activities, products and/or services. Stakeholders' actions are also reasonably expected to affect the ability of the organization to successfully implement its strategies and meet its objectives. This included entities or individuals whose rights under law or international conventions provide them with legitimate claims vis-à-vis the organization.

Stakeholders engagement activities are an important tool in this direction. These may include for example, stakeholder engagement for the purpose of compliance with internationally agreed standards, or informing ongoing organizational / business processes. Organizations can also use other means such as the media, the scientific community, or collaborative activities with peers and stakeholders.

'The reporting organization should identify its stakeholders and explain in its report how it has responded to their reasonable expectations and interests'

The GRI guidance requires organization to document the stakeholder engagement processes. This will make the sustainability report assurable.

When stakeholder engagement processes are used for reporting purpose, they should be based on systematic or generally accepted approaches, methodologies or principles. The idea is to develop a proper understanding of the stakeholder information needs. “The reporting organization should document its approach for defining which stakeholders it engaged with, how and when it engaged with them, and how engagement has influenced the report content and the organization’s sustainability activities”

Answer 8(iii)

Agenda 21 – a blueprint for sustainable development into the 21st Century which was agreed during the “Earth Summit” at Rio in 1992, and signed by 179 Heads of State and Government.

Agenda 21 is a guide for individuals, businesses and governments in making choices for development that help society and the environment. Agenda 21 deals with

1. *Social and economic dimensions* : developing countries; poverty; consumption patterns; population; health; human settlements; integrating environment and development.
2. *Conservation and management of resources* : atmosphere; land; forests; deserts; mountains; agriculture; biodiversity; biotechnology; oceans; fresh water; toxic chemicals; hazardous radioactive and solid waste and sewage.
3. *Strengthening the role of major groups* : women; children and youth; indigenous peoples; non-governmental organisations; local authorities; workers; business and industry; farmers; scientists and technologists.
4. *Means of implementation* : finance; technology transfer; science; education; capacity-building; international institutions; legal measures; information.

Answer 8(iv)

In the past all actions for environmental torts against companies and industries were governed by the principle of strict liability. Strict liability means liability without fault i.e., without intention or negligence. In other words, the defendant is held liable without fault. Absolute liability for the escape of impounded waters was first established in England during the mid-nineteenth century in the case of *Rylands v. Fletcher*, (1868) LR 3 330.

The liability under this rule is strict and it is no defence to say that the thing escaped without that person’s willful act, default or neglect or even that he had no knowledge of its existence. The House of Lords, however, added a rider to the above statement stating that – this rule applies only to non-natural user of the land and it does not apply to things naturally established on the land or where the thing escaped due to an act of God or an act of stranger or the default of the person injured or where the thing which escapes is present by the consent of the person injured or in certain cases where there is statutory authority.

Answer 8(v)

Leather industry is one of the three major industries besides paper and textiles, consuming large quantities of water for processing of hides and skins into leather. Naturally

most of the water used is discharged as waste water containing putrescible organic and toxic inorganic materials which when discharged as such will deplete dissolved oxygen content of the receiving water courses resulting in the death of all aquatic life and emanating foul odour. The *M.C. Mehta v. Union of India* [AIR 1988 SC 1037] also known as the Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court as evidence. The alarming details given by M.C. Mehta about the extent of pollution in the river Ganga due to the inflow of sewage from Kanpur only, the Court came down heavily on the Nagar Mahapalika (Municipality) and emphasised that it is the Nagar Mahapalika of Kanpur that has to bear the major responsibility for the pollution of the river near Kanpur city.

GOVERNANCE BUSINESS ETHICS AND SUSTAINABILITY

Time allowed: 3 hours

Maximum marks: 100

PART—A

(Answer Question No.1 which is **COMPULSORY** and **ANY TWO** of the rest from this part.)

Question 1

- (a) *"The silver lining in the Satyam episode is that it has opened a window of opportunity for corporate governance reforms in the country. Even though there has been a failure of the checks and balances in corporate governance, this crisis provides a great opportunity to rebuild our governance framework and regulatory control." In the context of this statement, examine the issues and challenges in corporate governance with special reference to the role of independent directors.* (10 marks)
- (b) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *An independent director is a director who has been an executive of the company in the immediate preceding three financial years.*
 - (ii) *Organisation for Economic Co-operation and Development (OECD) is not connected with corporate governance.*
 - (iii) *Insurance is a method of risk avoidance.*
 - (iv) *In India there is no legal requirement for separation of the role of the Chairman and Chief Executive officer.*
 - (v) *Shareholders Grievance Committee is a non-mandatory committee.*
- (2 marks each)

Answer 1(a)

The Satyam case led to a re-look at the corporate governance practices and framework prevalent in the country. This event highlighted the lack of independent directors interest in the Board processes, they did not play their role in efficient manner and the consequences proceeded.

The mere meeting of criteria of independence does not ensure that an independent director is acting independently. They should play a vigilant role by attending the meetings, studying and analysing the agenda papers, ask the right questions at the right time, insist that dissent if any is recorded, and have separate sessions of independent directors and act with integrity.

Some issues and challenges that need scrutiny are:

(i) The process of nomination and selection of independent directors

Globally it is considered a good practice to constitute a nomination committee, comprising a majority of independent directors. Such committee shall be responsible for nomination and selection of independent directors on the basis of certain specified criteria relating to age, qualifications etc.

(ii) Tenure of independent directors

Excessively long tenure of independent directors may compromise their independence. On being associated for a long period with a company, there is a strong likelihood of independent directors to lose their objectivity. Clause 49 does specify as a non-mandatory requirement that the maximum term should not exceed nine years.

(iii) Role of independent directors in audit committee

Independent directors' play a very crucial role in Audit Committee. The audit committee is responsible to ensure the integrity of financial reporting, therefore, each independent director who is a member of audit committee should be able to read and understand financial statements.

(iv) Training to Independent Directors

It is important that independent directors should undergo induction training which will enable new directors to gain understanding of

- company's financial, operational, strategic risk management position
- the rights, responsibilities and duties
- the role and responsibilities of senior executives
- the role of board committees.

In addition, all directors should undergo training from time to time.

(v) Flow of information to the board

Companies should ensure that timely, relevant and complete information is made available to independent directors so that they are able to make informed decisions. The independent directors on their part should also question and seek clarifications whenever in doubt.

(vi) Recording of dissent:

It is important that where an independent director is not in agreement with the decision of the majority, he should insist that his dissent be recorded.

Answer 1(b)(i)

Incorrect

Clause 49 of the Listing Agreement has provided that an 'Independent Director' shall mean a non-executive director of the company. Independent director is defined as a director who has not been an executive of the company in the immediately preceding 3 financial years.

Answer 1(b)(ii)

Incorrect

The Organisation for Economic Cooperation and Development (OECD) was one of the first non-governmental organizations to spell out the principles that should govern the corporate and issued the OECD Principles of Corporate Governance.

Answer 1(b)(iii)

Incorrect

Insurance is not a method of risk avoidance but it is a method of risk transfer. In this the risk is transferred to an organization that specializes in accepting risk at a price.

Answer 1(b)(iv)

Correct

There is no legal requirement of separation of roles of Chairman and CEO. However, the separation of the roles of the Chairman and CEO determines the composition of the Board of Director as per Listing Agreement.

Answer 1(b)(v)

Incorrect

Shareholders' Grievance Committee is a mandatory committee which has to be constituted by a listed entity, to which Clause 49 of the Listing Agreement is applicable.

Question 2

(a) Write notes on **any two** of the following:

- (i) Role of Company Secretary in ensuring risk management
 - (ii) Corporate governance in public sector undertakings
 - (iii) The Greenbury Report. (5 marks each)
- (b) Describe composition of the 'audit committee' and 'remuneration committee' as per clause 49 of the listing agreement. (5 marks)

Answer 2(a)(i)

ROLE OF COMPANY SECRETARY

As a top level officer and board confidante, a Company Secretary can play a significant role in ensuring that a sound enterprise wide risk management which is effective throughout the company is in place. The board of directors may have a risk management sub-committee assisted by a Risk Management Officer. As an officer responsible for coordination and communication for effective corporate functioning and governance, a Company Secretary shall ensure that there is an Integrated Framework on which a strong system of internal control is built. Such a Framework will become a model for discussing and evaluating risk management efforts in the organization. Risk and control consciousness should spread throughout the organization. A Company Secretary can ensure that this happens so that the risk factor will come into consideration at the every stage of formulation of a strategy. It will also create awareness about inter-relationships of risks across business units and at every level of the organization.

Answer 2(a)(ii)

CORPORATE GOVERNANCE IN PUBLIC SECTOR UNDERTAKING

The Ministry of Heavy Industries and Public Enterprises, Department of Public Enterprises has issued Guidelines on Corporate Governance for Central Public Sector Enterprises.

For the purpose of evolving Guidelines on corporate governance, Central Public Sector Enterprises (CPSEs) have been categorized into two groups, namely,— (i) those listed in the Stock Exchanges; (ii) those not listed in the Stock Exchanges.

CPSEs listed in Stock Exchanges

In so far as listed CPSEs are concerned, they have to follow the SEBI guidelines on corporate governance. In addition, they may follow those provisions in guidelines issued by Department of Public Enterprises which do not exist in the SEBI guidelines and also do not contradict any provisions in the SEBI guidelines.

Non-listed CPSEs

As per DPE directive, each PSE should strive to institutionalize good corporate governance practices broadly in conformity with the SEBI guidelines. The listing of the non-listed CPSEs in the stock exchanges may also be considered within a reasonable time frame to be set by the Administrative Ministry concerned in consultation with the CPSEs concerned. The non-listed CPSEs may follow the Guidelines on Corporate Governance, which are voluntary in nature.

The guidelines for listed and unlisted CPSEs deal with the subject of Corporate Governance, under the following headings:

- Board of Directors
- Audit Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation.

Answer 2(a)(iii)

The Greenbury Report (1995)

The confederation of British Industry set up a group under the Chairmanship of Sir Richard Greenbury. It was set up to examine the remuneration of the directors, particularly compensation packages, large pay increases and share options.

The Committee's findings were documented in the Greenbury Report, which incorporated a Code of Best Practice on Director's Remuneration.

Specifically, four main issues were dealt with, as follows:

- the role of a Remuneration Committee in setting the remuneration packages for the CEO and other directors;
- the required level of disclosure needed to shareholders regarding details of director's remuneration and whether there is the need to obtain shareholder approval;
- specific guidelines for determining a remuneration policy for directors; and
- service contracts and provisions binding the Company to pay compensation to a director, particularly in the event of dismissal for unsatisfactory performance.

The important recommendation was the establishment of Remuneration Committee composed of Non-Executive Directors which would be responsible for deciding the remuneration of executive directors. The majority of the recommendations of the Committee were incorporated in the Listing Rules of the

London Stock Exchange.

Answer 2(b)

Audit Committee

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation 1: The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2: A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3. The Chairman of the Audit Committee shall be an independent director;
4. The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
5. The Company Secretary shall act as the secretary to the committee.

Remuneration Committee

Constitution of Remuneration Committee is a non-mandatory requirement in terms of Clause 49 of the Listing Agreement. With regard to composition, it provides as under:

- (i) The remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.

Question 3

- (a) *“The Chairman's primary responsibility is to lead the Board and ensure its effectiveness.” Elucidate this statement. (5 marks)*
- (b) *Discuss the principles of corporate governance evolved by the Institute of Company Secretaries of India. (5 marks)*
- (c) *“Corporate Social Responsibility (CSR) is also called corporate citizenship or corporate responsibility.” Discuss. (5 marks)*

Answer 3(a)

The responsibility for ensuring that boards provide the leadership which is expected of them is that of its Chairperson. A Chairman though has no legal position; he is the person elected by the board to take the chair at a particular meeting.

Boards are not bound to continue with the same chairman for successive meetings. In law, all directors have broadly equal responsibilities and chairmen are no more equal than any other board member. Chairmen are an administrative convenience and a means of ensuring that board meetings are properly conducted.

The Chairman's primary responsibility is for leading the Board and ensuring its effectiveness.

The role of the Chairman includes:

- setting the Board agenda, ensuring that Directors receive accurate, timely and clear information to enable them to take sound decisions, ensuring that sufficient time is allowed for complex or contentious issues, and encouraging active engagement by all members of the Board;
- taking the lead in providing a comprehensive, formal and tailored induction programme for new Directors, and in addressing the development needs of individual Directors to ensure that they have the skills and knowledge to fulfill their role on the Board and on Board Committees;
- evaluating annually the performance of each Board member in his/her role as a Director, and ensuring that the performance of the Board as a whole and its Committees is evaluated annually. Holding meetings with the non-executive Directors without the executives being present;
- ensuring effective communication with shareholders and in particular that the company maintains contact with its principal shareholders on matters relating to strategy, governance and Directors' remuneration. Ensuring that the views of shareholders are communicated to the Board as a whole.

Answer 3(b)

The principles of corporate governance evolved by the ICSI are as under:

- Sustainable development of all stakeholders – to ensure growth of all individuals associated with or effected by the enterprise on sustainable basis.
- Effective management and distribution of wealth – to ensure that enterprise creates maximum wealth and judiciously uses the wealth so created for providing maximum benefits to all stakeholders and enhancing its wealth creation capabilities to maintain sustainability.
- Discharge of social responsibility – to ensure that enterprise is acceptable to the society in which it is functioning.
- Application of best management practices – to ensure excellence in functioning of enterprise and optimum creation of wealth on sustainable basis.
- Compliance of law in letter and spirit – to ensure value enhancement for all stakeholders guaranteed by the law for maintaining socio-economic balance.
- Adherence to ethical standards – to ensure integrity, transparency, independence and accountability in dealings with all stakeholders.

Answer 3(c)

Corporate Social Responsibility (CSR) is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. The main function of an

enterprise is to create value through producing goods and services that society demands, thereby generating profit for its owners and shareholders as well as welfare for society, particularly through an ongoing process of job creation.

Corporate Social Responsibility can be explained as under:

Corporate means organized business.

Social means dealing with the people/society including environment.

Responsibility means accountability of the corporate towards society.

The term corporate citizenship implies the behaviour which would maximize a company's positive impact and minimize the negative impact on its social and physical environment.

CSR means open and transparent business practices that are based on ethical values and respect for employees, communities and the environment.

Corporate Social Responsibility is also called corporate citizenship or corporate responsibility.

Question 4

(a) Describe briefly **any three** of the following :

- (i) Barriers to 'visionary leadership'.
- (ii) Social accountability and the 'AA 1000'.
- (iii) Diligence report in banks.
- (iv) Scope of work of the Asian Corporate Governance Association.

(3 marks each)

(b) Describe and differentiate 'risk reduction' and 'risk retention'. (6 marks)

Answer 4(a)(i)

Barriers to Visionary Leadership

Frank Martinelli - Lists the barriers with a view to helping companies identify them in their organizations and to remove them to facilitate visionary board leadership:

1. Micro Management - It is necessary that the board focuses its attention on items of critical importance to the organization. If the board is tempted to micro manage or to meddle in lesser matters, an opportunity to provide visionary leadership is lost.
2. Clinging to Tradition – Boards often resist change in order to preserve tradition. However, changing environment requires the Boards to be open to change.
3. Confused Roles - Some boards assume that it is the job of the executive director to do the visionary thinking and that the board will sit and wait for direction and inspiration.
4. Time Management - Lack of time to attend meetings, read materials and maintain contact with each other in between meetings.
5. Resistance to risk taking - Board leadership must strike a balance between taking chances and maintaining the traditional stewardship role.

6. Strategic Planning - Strategic planning offers boards an opportunity to think about changes and trends that will have significant impact and develop strategies to respond to challenges.
7. Complexity - Board members frequently lack a deep understanding of critical changes, trends and developments that challenge fundamental assumptions about how it defines its work.

Answer 4(a)(ii)

The Social Accountability - SA 8000 is a certification standard based on the UN Universal Declaration of Human Rights, Convention SA 8000 seeks to provide transparent, measurable and verifiable performance standards in the areas of child labour; forced labour; health and safety; compensation; working hours; discrimination; discipline; free association and collective bargaining; and management systems.

The AA 1000 - framework developed by the Institute of Social and Ethical Accountability provides a standard for social and ethical accounting, auditing and reporting, including mandatory external verification and stakeholder engagement.

It aims to assist an organisation in the definition of goals and targets, the measurement of progress made against these targets, the auditing and reporting of performance and in the establishment of feedback mechanisms. This is done by

- Developing stakeholder engagement strategy - an integrated strategy for stakeholder engagement that strengthens both their relationships with stakeholders and their internal decision making processes.
- Facilitation of Stakeholder Dialogues - support through the planning, design, capacity building, facilitation and follow-up stages of stakeholder engagement to create processes that create change.
- Capacity building for stakeholder engagement - Engaging with stakeholders requires new skills and ways of thinking. Through in-house training in stakeholder engagement, as well as ongoing mentoring support for leadership teams.

Answer 4(a)(iii)

The Reserve Bank of India recently has advised all the scheduled commercial Banks to obtain regular certification (Diligence Report) by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue. The Diligence Report will not only act as an effective mechanism to ensure that the legal and procedural requirements under the respective legislations are duly complied with but also instill professional discipline in the working of the companies that have taken loan, besides building up the necessary confidence in the state of affairs of the companies.

Answer 4(a)(iv)

Asian Corporate Governance Association's scope of work covers three areas:

1. Research:

Tracking corporate governance developments across 11 markets in Asia and producing independent analyses of new laws and regulations, investor

activism and corporate practices.

2. **Advocacy:**

Engaging in a constructive dialogue with financial regulators, stock exchanges, institutional investors and companies on practical issues affecting the regulatory environment and the implementation of better corporate governance practices in Asia.

3. **Education:**

Organising conferences and seminars that foster a deeper understanding of the competitive benefits of sound corporate governance and ways to implement it effectively.

Answer 4(b)

Risk Reduction

The Physical risk reduction (or loss prevention, as it is often called) is one of ways of dealing with any risk situation. It is done in steps to reduce the probability of loss. The ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be achieved at little or no extra cost. Risks are reduced by taking actions to lessen the probability of negative consequences associated with a risk. The only cautionary note regarding risk reduction is that, as far as possible expenditure should be related to potential future saving in losses and other risk costs; in other words, risk prevention generally should be evaluated in the same way as other investment projects.

Risk Retention

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

- (i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.
- (ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

PART—B

(Answer ANY TWO questions from this part)

Question 5

- (a) *You are the Company Secretary of Universal Development Ltd. The company often faces ethical dilemma. The Board wants to circulate a guidance note for its managers to resolve ethical dilemma. Draft guidance note for the consideration and approval of the Board. (7 marks)*
- (b) *Write notes on any two of the following :*
 - (i) *Ethics in finance*
 - (ii) *Ethics training and communication*
 - (iii) *Stakeholder orientation. (4 marks each)*

Answer 5(a)

Universal Development Limited

Draft of the guidance note for resolving an ethical dilemma

Steps to Resolving an Ethical Dilemma:

(i) What are the options?

List the alternative courses of action available.

(ii) Consider the Consequences

Think carefully about the range of positive and negative consequences associated with each of the different paths of action available.

- Who/What will be helped by what is done?
- Who/What will be hurt?
- What kinds of benefits and harms are involved and what are their relative values?
- What are the short-term and long-term implications?

(iii) Analyse the actions

Actions should be analysed in a different perspective i.e. viewing the action per se disregard the consequences concentrating instead on the actions and looking for that option which seem problematic. How do the options measure up against moral principles like honesty, fairness, equality and recognition of social and environmental vulnerability?

In the case you are considering, is there a way to see one principle as more important than the others?

(iv) Make decision and act with commitment

Now, both parts of analysis should be brought together and a conscious and informed decision should be made once the decision is made, act on the decision assuming responsibility for it.

(v) Evaluate the system

Think about the circumstances which led to the dilemma with the intention of identifying and removing the conditions that allowed it to arise.

Sd/-

ABC

(Company Secretary)

For Universal Development Limited

Answer 5(b)(i)

Ethics in Finance

The ethical issues in finance that companies and employees are confronted with include:

- In accounting – window dressing, misleading financial analysis.
- Related party transactions not at arms length

- Insider trading, securities fraud leading to manipulation of the financial markets.
- Executive compensation.
- Bribery, kickbacks, over billing of expenses, facilitation payments.

Answer 5(b)(ii)

ETHICS TRAINING AND COMMUNICATION

A major step in developing an effective ethics program is implementing a training program and communication system to communicate and educate employees about the firm's ethical standards.

Training can educate employees about the firm's policies and expectations, as well as relevant laws and regulations and general social standards. Training programs can make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice. They can also empower employees to ask tough questions and make ethical decisions. Many companies are now incorporating ethics training into their employee and management development training efforts.

If ethics training is to be effective, it must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program. Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics.

To be successful, business ethics programs should educate employees about formal ethical frameworks and more for analyzing business ethics issue. Then employees can base ethical decisions on their knowledge of choices rather than on emotions.

Answer 5(b)(iii)

STAKEHOLDER ORIENTATION

The degree to which a firm understands and addresses stakeholder demands can be referred to as a stakeholder orientation. This orientation comprises three sets of activities: (1) the organization wide generation of data about stakeholder groups and assessment of the firm's effects on these groups, (2) the distribution of this information throughout the firm, and (3) the organization's responsiveness as a whole to this intelligence.

A stakeholder orientation is not complete unless it includes activities that actually address stakeholder issues. The responsiveness of the organization as a whole to stakeholder intelligence consists of the initiatives the firm adopts to ensure that it abides by or exceeds stakeholder expectations and has a positive impact on stakeholder issues. Such activities are likely to be specific to a particular stakeholder group (e.g., family friendly work schedules) or to a particular stakeholder issue (e.g., pollution reduction programs). Noticeably, these responsiveness processes may involve the participation of the concerned stakeholder groups.

Question 6

- (a) *Explain the Clarkson principles of stakeholder management.* (5 marks)
- (b) *"A commitment by corporate management to follow an ethical code of conduct confers a variety of benefits." What are these benefits?* (5 marks)
- (c) *What is 'social and ethical accounting'?* (5 marks)

Answer 6(a)

THE CLARKSON PRINCIPLE OF STAKEHOLDER MANAGEMENT

Max Clarkson (1922-1998) founded the Centre for Corporate Social Performance and Ethics in the Faculty of Management.

Principle 1: Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2: Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3: Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4: Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

Principle 5: Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6: Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 6 (b)

ADVANTAGES OF BUSINESS ETHICS

More and more companies recognize the link between business ethics and financial performance. Companies displaying a "clear commitment to ethical conduct" consistently outperform companies that do not display ethical conduct. Code of Conduct is formal statement that describes what an organization expects of its employees.

Adherence to a Code of Conduct offers the following advantages:

It deters wrongdoing and promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the company;
3. Compliance with applicable governmental laws, rules and regulations;
4. The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and,
5. Accountability for adherence to the code.

Answer 6 (c)

SOCIAL AND ETHICAL ACCOUNTING

Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the (i) development of policies and, performance targets and (ii) to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized balance sheet or unit of currency. The issues are defined by the company's values and aims by the interests and expectations of its stakeholders, and by societal norms and regulations. With the focus on the concerns of society, the social and ethical accounting framework implicitly concerns itself with issues such as economic performance, working conditions, environmental and animal protection, human rights, fair trade and ethical trade, human resource management and community development, and hence with the sustainability of a company's activities.

The dominant principle of social and ethical accounting is inclusivity. This principle requires that the aspirations and needs of all stakeholder groups are taken into account at all stages of the social and ethical accounting process.

Question 7

- (a) *Elaborate the various 'ethics philosophies'. (5 marks)*
- (b) *"An organisation's structure is important to the study of business ethics." Comment. (5 marks)*
- (c) *Explain and differentiate 'ethical decisions' and 'ethical dilemma'. (5 marks)*

Answer 7(a)

The following are some of the ethics philosophies.

Deontological ethics or deontology (Greek: (deon) meaning 'obligation' or 'duty') is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions. This can be clarified with an example – if a manager decides that it is his duty to always be on time to meetings is running late for reasons not in his control,

how is he supposed to drive to reach the meeting on time? Is he supposed to speed, breaking his duty to uphold the law, or is he supposed to arrive at his meeting late, breaking his duty to be on time?

Teleology (Greek: telos: end, purpose) is the philosophical study of design and purpose. A teleological school of thought is one that holds all things to be designed for or directed toward a final result, that there is an inherent purpose or final cause for all that exists.

Enlightened-egoism. This model takes into account harms, benefits and rights. Therefore, under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company's providing the scholarship benefits the needy students, but ultimately it is in the company's self interest.

Utilitarianism is the idea that the moral worth of an action is solely determined by its contribution to overall utility, that is, its contribution to happiness or pleasure as summed among all persons. It can be described by the phrase "the greatest good for the greatest number". For example, one may be tempted to steal from a rich wastrel to give to a starving family.

Relativism is the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects. The term often refers to truth relativism, which is the doctrine that there are no absolute truths, i.e., that truth is always relative to some particular frame of reference, such as a language or a culture. For example, killing animals for sport (like bull fighting) could be right for one culture and wrong in another culture.

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen article.

Justice is the concept of moral rightness in action or attitude; it is closely linked to fairness. A conception of justice is one of the key features of society.

Answer 7(b)

An organization's structure is important to the study of business ethics. In a **Centralized organization**, decision-making authority is concentrated in the hands of top-level managers, and little authority is delegated to lower levels. Responsibility, both internal and external, rests with top management. This structure is especially suited for organizations that make high-risk decisions and whose lower-level managers are not highly skilled in decision making. It is also suitable for organizations in which production processes are routine and efficiency is of primary importance.

These organizations are usually extremely bureaucratic, and the division of labour is typically very well defined. Each worker knows his or her job and what is

specifically expected, and each has a clear understanding of how to carry out assigned tasks. Centralized organizations stress formal rules, policies, and procedures, backed up with elaborate control systems. Their codes of ethics may specify the techniques to be used for decision making.

Because of their top-down approach and the distance between employee and decision maker, centralized organizational structures can lead to unethical acts. If the centralized organization is very bureaucratic, some employees may behave according to “the letter of the law” rather than the spirit.

In a **decentralized organization**, decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, and coordination and control are usually informal and personal. They focus instead on increasing the flow of information. As a result, one of the main strengths of decentralized organizations is their adaptability and early recognition of external change. With greater flexibility, managers can react quickly to changes in their ethical environment. Weakness of decentralized organizations is the difficulty they have in responding quickly to changes in policy and procedures established by top management. In addition, independent profit centers within a decentralized organization may deviate from organizational objectives.

Answer 7(c)

By definition, an ethical dilemma involves the need to choose from among two or more morally acceptable courses of action when one choice prevents selecting the other or the need to choose between equally unacceptable alternatives.

Ethical decision is arrived at by resolving the ethical dilemma, by following a certain predetermined procedure or a method.

An ethical dilemma is a situation that will often involve an apparent conflict between moral imperatives, in which to obey one would result in transgressing another. While ethical decision involves selection of one moral imperative by abandoning the other.

An ethical dilemma involves a situation that makes a person question what is the ‘right’ or ‘wrong’ thing to do, while ethical decision results in selection of right thing to do.

Ethical dilemmas make individuals think about their obligations, duties or responsibilities. Most ethical decisions have personal implications.

PART—C

Question 8

*Attempt **any four** of the following:*

- (i) Write note on ‘life cycle assessment’.*
- (ii) Discuss the concept of ‘sustainable development’.*
- (iii) What is the main function of ‘global reporting initiatives’?*
- (iv) State any five principles of Rio Declaration on Environment and Development.*
- (v) Once the activity carried out by any person is hazardous or inherently dangerous, the person carrying on such activity is liable to make good the loss caused to any other person by his activity. Whether in such case the*

*plea that reasonable care was taken while carrying out such activity is valid?
Discuss in the light of decided case law. (5 marks each)*

Answer 8(i)

Life Cycle Assessment (LCA)

Life Cycle Assessment tracks the environmental impacts of a product from its raw materials through disposal at the end of its useful life. LCA is an important tool for developing an environmental self-portrait and for finding ways to minimize harm. A good LCA can shed light on ways to reduce the resources consumed and lower costs all along the value chain.

A Life Cycle Assessment looks at this complete circle and measures environmental impact at every phase. It provides the foundation for understanding the issues a company must address and clues to help find Eco-Advantage.

Answer 8(ii)

Sustainable development is a broad concept that balances the need for economic growth with environmental protection and social equity. It is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations. Sustainable development is a broad concept and it combines economics, social justice, environmental science and management, business management, politics and law.

In 1987, a report of the World Commission on Environment and Development of the United Nations (popularly known as Brundtland Report) first introduced the concept. The Commission describes Sustainable Development as a process of change in which the exploitation of resources, the direction of investments, and the orientation of technological development ... instrumental change and the ability of biosphere to absorb the effects of human activities are consistent with future as well as present needs.

It indicates development that meets the needs of the present generation without compromising the ability of the future generations to meet their needs.

Answer 8(iii)

GLOBAL REPORTING INITIATIVE

The Sustainability Reporting Guidelines developed by the Global Reporting Initiative (GRI), the Netherlands, is a significant system that integrates sustainability issues in to a frame of reporting.

The GRI also admits that in the era of unprecedented economic growth, achieving this goal can seem more of an aspiration than a reality.

Organisation's purpose is not more merely to engage in a creative operation or activity. Be it a business organization or a non-profit or non-government organization its operation must also address the concerns of sustainable development.

The GRI Reporting framework intends to serve as a generally accepted framework for reporting on an organization's economic, environmental and social performance. Organisations of any size, sector or location can use it. The framework

contains general and sector specific content for reporting an organization's sustainability performance.

The GRI sustainability Reporting Guidelines consist of Principles for defining report content and for ensuring the quality of reported information.

Answer 8 (iv)

The Rio Declaration on Environment and Development consists of following 27 principles intended to guide future sustainable development around the world.

1. Human beings are at the centre of concerns for sustainable development. They are entitled to a healthy and productive life in harmony with nature.
2. States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.
3. The right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations.
4. In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.
5. All States and all people shall cooperate in the essential task of eradicating poverty as an indispensable requirement for sustainable development, in order to decrease the disparities in standards of living and better meet the needs of the majority of the people of the world.
6. The special situation and needs of developing countries, particularly the least developed and those most environmentally vulnerable, shall be given special priority. International actions in the field of environment and development should also address the interests and needs of all countries.
7. States shall cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth's ecosystem. In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities. The developed countries acknowledge the responsibility that they bear in the international pursuit to sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command.
8. To achieve sustainable development and a higher quality of life for all people, States should reduce and eliminate unsustainable patterns of production and consumption and promote appropriate demographic policies.
9. States should cooperate to strengthen endogenous capacity-building for sustainable development by improving scientific understanding through exchanges of scientific and technological knowledge, and by enhancing the development, adaptation, diffusion and transfer of technologies, including new and innovative technologies.
10. Environmental issues are best handled with participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to information concerning the environment that is held by

public authorities, including information on hazardous materials and activities in their communities, and the opportunity to participate in decision-making processes. States shall facilitate and encourage public awareness and participation by making information widely available. Effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.

11. States shall enact effective environmental legislation. Environmental standards, management objectives and priorities should reflect the environmental and development context to which they apply. Standards applied by some countries may be inappropriate and of unwarranted economic and social cost to other countries, in particular developing countries.
12. States should cooperate to promote a supportive and open international economic system that would lead to economic growth and sustainable development in all countries, to better address the problems of environmental degradation. Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on an international consensus.
13. States shall develop national law regarding liability and compensation for the victims of pollution and other environmental damage. States shall also cooperate in an expeditious and more determined manner to develop further international law regarding liability and compensation for adverse effects of environmental damage caused by activities within their jurisdiction or control to areas beyond their jurisdiction.
14. States should effectively cooperate to discourage or prevent the relocation and transfer to other States of any activities and substances that cause severe environmental degradation or are found to be harmful to human health.
15. In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.
16. National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.
17. Environmental impact assessment, as a national instrument, shall be undertaken for proposed activities that are likely to have a significant adverse impact on the environment and are subject to decision of a competent national authority.
18. States shall immediately notify other States of any natural disasters or other emergencies that are likely to produce sudden harmful effects on the

environment of those States. Every effort shall be made by the international community to help States so afflicted.

19. States shall provide prior and timely notification and relevant information to potentially affected States on activities that may have a significant adverse transboundary environmental effect and shall consult with those States at an early stage and in good faith.
20. Women have a vital role in environmental management and development. Their full participation is therefore essential to achieve sustainable development.
21. The creativity, ideals and courage of the youth of the world should be mobilized to forge a global partnership in order to achieve sustainable development and ensure a better future for all.
22. Indigenous people and their communities and other local communities have a vital role in environmental management and development because of their knowledge and traditional practices. States should recognize and duly support their identity, culture and interests and enable their effective participation in the achievement of sustainable development.
23. The environment and natural resources of people under oppression, domination and occupation shall be protected.
24. Warfare is inherently destructive of sustainable development. States shall therefore respect international law providing protection for the environment in times of armed conflict and cooperate in its further development, as necessary.
25. Peace, development and environmental protection are interdependent and indivisible.
26. States shall resolve all their environmental disputes peacefully and by appropriate means in accordance with the Charter of the United Nations.
27. States and people shall cooperate in good faith and in a spirit of partnership in the fulfilment of the principles embodied in this Declaration and in the further development of international law in the field of sustainable development.

Note: Candidates can list out any five of the above principles.

Answer 8(v)

The Apex Court held that the rule laid down by Supreme Court in Oleum gas leak case (AIR 1987 SC 1086), namely that once the activity carried on is hazardous or inherently dangerous, the person carrying on such activity is liable to make good the loss caused to any other person by his activity irrespective of the fact whether he took reasonable care while in carrying his activity is by for the more appropriate one and binding, the rule is premised upon the very nature of the activity carried on. In the words of the Constitution Bench, 'such an activity can be tolerated only on the condition that the enterprise engaged in such hazardous or inherently dangerous activity indemnifies all those who suffer on account of the carrying on of such hazardous or inherently dangerous activity regardless whether it is carried on carefully or not. The Constitution Bench has also assigned the reason for stating the law in the said terms. It is that the enterprise (carrying on the hazardous or inherently dangerous activity) alone has the resource to discover and guard against hazards and dangerous and not the person affected and the practical difficulty on the part of

the affected person, in establishing the absence of reasonable care or that the damage to him was foreseeable by the enterprise.

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

*(Answer Question No. 1 which is compulsory
and any two of the rest from this part)*

Question 1

- (a) *“Independent directors are known to bring objective view in Board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.”*
Discuss the above statement in the light of Clause 49 of the listing agreement.
(10 marks)
- (b) *State, with reasons in brief, whether the following statements are true or false :*
- (i) *Kautilya’s Arthashastra maintains that for good governance all administrators including the king were considered the masters of the people.*
 - (ii) *Clause 49 of the listing agreement obligates a company to make disclosure about the remuneration of directors.*
 - (iii) *Any person, who has access to the price sensitive information, need not be an ‘insider’.*
 - (iv) *Board meetings should be held at least four times in a year with a maximum gap of six months.*
 - (v) *Shareholders activism does not refer to the active involvement of stakeholders in their company.*
(2 marks each)

Answer 1(a)

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.

Independent Directors bring a valuable outside perspective to the deliberations. They contribute significantly to the decision-making process of the Board. They can bring on objective view to the evaluation of the performance of Board and management. In addition, they can play an important role in areas where the interest of management, the company and shareholders may diverge such as executive remuneration, succession planning, changes in corporate control, audit function etc.

Independent directors are required because they perform the following important role :

- (i) Balance the often conflicting interests of the stakeholders.
- (ii) Facilitate withstanding and countering pressures from owners.

- (iii) Fulfill a useful role in succession planning.
- (iv) Act as a coach, mentor and sounding Board for their full time colleagues.
- (v) Provide independent judgment and wider perspectives.

In this context, the Clause 49 requires that the Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. In terms of Clause 49 of the Listing Agreement, at least one-third of the Board should comprise of independent directors where the Chairman of the Board is a non-executive director, and in case the Chairman is an executive director, at least half of the Board should comprise of independent directors.

Further, where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.”

As per Clause 49, an independent director shall mean a mean a non-executive director of the company director who:

- (a) apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
- (b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company, and
 - (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director; and
- (f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares;
- (g) is not less than 21 years of age.

Answer 1(b)(i)

False. Kautilya’s Arthashastra maintains that for good governance, all administrators including the King were considered the servants of the people.

Answer 1(b)(ii)

True. Clause 49 of the listing agreement obligates a company to make disclosure about the remuneration of directors.

Answer 1(b)(iii)

False. In terms clause 2 (e) (ii) of SEBI (Prohibition of Insider Trading) Regulations, 1992, Insider is any person who has received or has had access to unpublished price sensitive information in respect of securities of the company.

Answer 1(b)(iv)

False. Board meetings should be held at least four times in a year with a maximum gap of four months.

Answer 1(b)(v)

False. Shareholder activism refers to the active involvement of stockholders in their organization.

Question 2

(a) Write short notes on any three of the following :

- (i) *The Turnbull Report*
- (ii) *CII's Desirable Corporate Governance Code*
- (iii) *Role of institutional investors in Corporate Governance*
- (iv) *Shareholders' rights.* (3 marks each)

(b) *Juris Global Ltd., an LPO company, aims for listing at New York Stock Exchange (NYSE). The companies listed on the NYSE are required to comply with certain standards regarding Corporate Governance as prescribed in the NYSE's listing rules. Your company will be required, inter alia, to comply with these rules.*

As a Company Secretary, you are required to prepare a Board note highlighting the provisions of the NYSE's listing rules with respect to the Board structure and constitution of various committees of the Board. (6 marks)

Answer 2(a)(i)**The Turnbull Report**

The original Combined Code required companies to include a narrative statement in their Annual Report of how internal control provisions had been applied. However, the combined code did not have guidelines of how the provisions should be applied by the companies. This led to the establishment of a Working Group under the Chairmanship of Nigel Turnbull. Turnbull Committee published "Internal Control Guidance for Directors on Combined Code".

In 2004, the Financial Reporting Council established the Turnbull Review Group to consider the impact of the guidance and the related disclosures and to determine whether the guidance needed to be updated. In October 2005, the revised guidance was issued.

Answer 2(a)(ii)**CII'S Desirable Corporate Governance Code**

Confederation of Indian Industry (CII) took a special initiative on Corporate Governance, the first institution initiative in Indian Industry. The objective was to develop

and promote a code for Corporate Governance to be adopted and followed by Indian companies, whether in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities. The final draft of the said Code was widely circulated in 1997. In April 1998, the Code was released. It was called Desirable Corporate Governance Code.

Answer 2(a)(iii)

Institutional shareholders should reflect the following characteristics:

- Take active interest in the composition of board of Directors
- Be vigilant
- Maintain regular and systematic contact at senior level for exchange of views on management, strategy, performance and quality of management
- Ensure that voting intentions are translated into practice
- Evaluate Corporate Governance performance of the company

The Combined Code (2008) stated the following principles of good governance for the Institutional Shareholders

(a) *Dialogue with companies*

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

(b) *Evaluation of governance disclosures*

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional Investors should give due weight to all relevant factors drawn to their attention.

(c) *Shareholder voting*

Institutional shareholders have a responsibility to make considered use of their votes.

Answer 2(a)(iv)**Shareholders' Rights**

The provisions of Companies Act 1956 guarantee shareholders with several rights some of which have been discussed hereunder :

- Right to receive copies of the abridged balance-sheet and profit & loss account, report of cost auditor, contracts for appointment of the managing director/manager & notices of the general meetings of the company
- Right to inspect statutory registers/ returns and get copies thereof on payment of prescribed fee.
- Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy.

- Apart from these shareholders have right to receive share certificates, transfer shareholdings, right to receive dividend when declared, to appoint directors, right to share the surplus assets on winding up, right to collectively make application to the Central Government for the investigation of the affairs of the company.
- Under section 106 the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or sanction in a separate meeting.
- Right to make application collectively to Company Law Board/ tribunal for oppression and mismanagement.
- Right of Dissentient shareholders to apply to the court.

Answer 2(b)

Board of Directors

Juris Global Limited

Sub : A note on the listing Requirements of NYSE in respect of Board structure and its committees.

Companies listed on the New York Stock Exchange are required to comply with certain standards regarding corporate governance NYSE Listing Rules. The relevant provisions of the New York Stock Exchange's Listing Rules are summarized below:

Board Structure

Listed companies must have a majority of independent directors

This condition is however not applicable to the following companies:

- A company of which more than 50% of the voting power is held by an individual, a group or another company.
- Limited partnerships and companies in bankruptcy proceedings need not comply with the requirements
- Listed companies that are foreign private issuers are permitted to follow home country practice in lieu of this provision

Criteria for determining Independence of Director

- (i) A director who is an employee or whose immediate family member is an executive officer, of the company is not independent until three years after the end of such employment relationship.
- (ii) A director who receives, or whose immediate family member receives, more than \$100,000 per year in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service, is not independent until three years after he or she ceases to receive more than \$100,000 per year in such compensation.
- (iii) A director who is affiliated with or employed by, or whose immediate family

member is affiliated with or employed in a professional capacity by, a present or former internal or external auditor of the company is not “independent” until three years after the end of the affiliation or the employment or auditing relationship.

- (iv) A director who is employed, or whose immediate family member is employed, as an executive officer of another company where any of the listed company’s present executives serve on that company’s compensation committee is not “independent” until three years after the end of such service or the employment relationship.
- (v) A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of a company that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any single fiscal year, exceeds the greater of \$1 million, or 2% of such other company’s consolidated gross revenues, is not “independent” until three years after falling below such threshold.

Audit Committee

Listed companies must have an audit committee

Composition of Audit Committee

- The audit committee must have a minimum of three members.
- All the members of the Audit Committee must be independent
- Each member of the audit committee must be financially literate, as such qualification is interpreted by the company’s board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee.
- In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company’s board interprets such qualification in its business judgment.

Remuneration/Compensation Committee

Listed companies must have a compensation committee composed entirely of independent directors.

Nominating/Corporate Governance Committee

Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.

Sd/-

Company Secretary

Question 3

- (a) “The rapidly growing global economy has created an expanding array of risks to be managed to ensure the viability and success of an enterprise.” Discuss this statement enumerating various classes of risks and the ways of risk handling.
(5 marks)

- (b) *“Corporate social responsibility is an evolving concept.” Describe and distinguish ‘corporate social responsibility’ with ‘corporate philanthropy’.* (5 marks)
- (c) *“Corporate communication is all about managing perceptions and ensuring effective and timely dissemination of information, positive corporate image, and smooth and affirmative relationship with all stakeholders.” Explain and outline the scope of corporate communication.* (5 marks)

Answer 3(a)

Risk may be broadly classified under the following heads:

- (a) Industry & Services Risks
- (b) Management and Operations Risks
- (c) Market Risks
- (d) Political Risks
- (e) Credit Risks
- (f) Liquidity Risks
- (g) Disaster Risks
- (h) Systems Risks
- (i) Legal Risks
- (j) Non-compliance and related risk

Risk Handling

Firms are not entirely free to decide on how they shall handle their risks. In every country there are governmental and official regulations governing health and safety at work like fire precautions, hygiene, environmental pollution, food, handling of dangerous substances and many other matters relating to properties, personal injuries and other risks. The Central Government and State Governments have enacted compulsory insurance regulations (for vehicles and individuals). And in addition a firm may be obliged to insure certain risks under provisions of leases, construction and other contracts. Failure to comply with both safety and compulsory insurance regulations may constitute a criminal offence and may lead to the closure of a plant or other establishments. Thus, if a firm wishes to carry on certain activities it must comply with the relevant official risk handling regulations. There will remain, however, broad areas where it can exercise its own discretion to control physical or financial loss.

Risks can be handled broadly in four ways:

Risk Avoidance

It is a rare possibility to avoid a risk completely. A riskless situation is rare. Generally risk avoidance is only feasible at the planning stage of an operation.

Risk Reduction

In many ways physical risk reduction (or loss prevention, as it is often called) is the best way of dealing with any risk situation and usually, it is possible to take steps to reduce the probability of loss. Again, the ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be

achieved at little or no extra cost. The only cautionary note regarding risk reduction is that, as far as possible expenditure should be related to potential future saving in losses and other risk costs; in other words, risk prevention generally should be evaluated in the same way as other investment projects.

Risk Retention

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

- (i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.
- (ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

Risk Transfer

This refers to legal assignment of cost of certain potential losses to another. The insurance of 'risks' is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz., (i) By Tort (ii) By contract other than insurance (iii) By contract of insurance. The main method of risk transfer is insurance. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses arising from the occurrence of a specified peril. Thus, insurance substitutes certainty for uncertainty. Insurance does not protect a firm against all perils but it offers restoration, atleast in part of any resultant economic loss.

Answer 3(b)

Philanthropy means the act of donating money, goods, time or effort to support a charitable cause with regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

The Etymological origin of the word is from Late Latin philanthropia, from Greek philanthropia, from philanthropos loving people that is phil- + anthropos human being. It is the active effort to promote human welfare.

Corporate Social Responsibility on the other hand is about how a company align their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/or planet issues. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

Answer 3(c)

Corporate communication means the corporation's voice and the images it projects of itself to the various stakeholders. This includes various areas such as corporate

reputation, corporate advertising, and employee communications, government relations and media management. These days most of the bigger organizations have departments of corporate communication which appears on the organizational chart along with traditional functions like marketing or accounting.

The corporate communication can also be defined as the processes a company uses to communicate all its messages to key constituencies –

- a combination of meetings,
- interviews,
- speeches,
- reports,
- images
- advertising, and
- on-line communication.

Ideally, corporate communication is an attitude or a set of mental habits that employees internalize. The result is good communication practices that permeate an organisation and are present in all its communications with constituencies.

Corporate communications also includes all the products of communication, such as memos, letters, reports, websites, e-mails, speeches or new releases. In the aggregate of these messages is what a company sends to its constituencies, whether internal or external. The communications can be written communication verbal or spoken communications or non-verbal communications. Electronic channels like email, voice mail, telephone calls video conferencing and chat sessions are gaining more importance as communication channels.

Question 4

(a) *Describe briefly any three of the following :*

- (i) *ICSI initiatives towards Corporate Governance*
- (ii) *Prohibition on insider trading*
- (iii) *Mandatory committees under the listing agreement*
- (iv) *COSO's internal control framework.* (3 marks each)

(b) *Enumerate any six Corporate Governance Forums worldwide, which are instrumental in promoting the culture of creativity and compliance among corporates.* (6 marks)

Answer 4(a)(i)

ICSI's Philosophy on Corporate Governance

The ICSI, after extensive research, has taken a lead step in defining Corporate Governance as “the application of best management practices, compliance of law in letter and spirit and adherence to ethical standards for effective management and

distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”

The ICSI National Awards for Excellence in Corporate Governance

In pursuit for excellence and to identify, foster and reward the culture of evolving globally acceptable standards of corporate governance among Indian companies, the Institute instituted the “ICSI National Award for Excellence in Corporate Governance” in the year 2001. The underlying guideline for the Corporate Governance Award is to identify the corporates, which best establish and follow, corporate governance norms in letter and spirit.

Institute’s Post Membership Qualification Course in Corporate Governance

In order to update members of ICSI about best practices in Corporate Governance, the ICSI has introduced Post Membership Qualification Course in Corporate Governance.

Some of ICSI’s other major initiatives in Corporate Governance include

- ICSI Recommendations to Strengthen Corporate Governance Framework.
- ICSI- Centre for Corporate Governance Research and Training
- Founder Trustee of National Foundation For Corporate Governance
- Secretarial Standards Board
- Segmentwise Role of Company Secretaries
- Directors’ Training and Orientation Investor Education Programmes
- MOU with Chambers on CSR

Answer 4(a)(ii)

Prohibition on insider trading

Regulation 2(e) of Securities and Exchange Board of India (Prohibition of Insider trading) Regulations, 1992 defines “insider” as any person who,

- (i) is or was connected with the company or is deemed to have been connected with the company and is reasonably expected to have access to unpublished price sensitive information in respect of securities of a company, or
- (ii) has received or has had access to such unpublished price sensitive information;

Regulation 3 of aforesaid regulations provide for restriction on trading of securities by providing that no insider shall—

- (i) either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information; or
- (ii) communicate or counsel or procure directly or indirectly any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities.

It further provides that nothing contained above shall be applicable to any communication required in the ordinary course of business or profession or employment or under any law.

Answer 4(a)(iii)

Mandatory Committees

Audit Committee and Shareholder Grievance Committees are mandatory committees which has to be constituted by a listed entity to whom clause 49 of the Listing Agreement is applicable

A qualified and independent audit committee shall be set up, having minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.

In terms of Clause 49-IV(G)(iii) of the Listing Agreement, a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

Answer 4(a)(iv)

COSO is the acronym for Committee of Sponsoring Organizations of the Treadway Commission. COSO is a U.S. private-sector initiative. Its major objective is to identify the factors that cause fraudulent financial reporting and to make recommendations to reduce its Incidence. COSO has established a common definition of internal controls, standards, and criteria against which companies and organizations can assess their control systems.

Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations.

Answer 4(b)

(i) National Foundation for Corporate Governance (NFCG)

With the goal of promoting better corporate governance practices in India, the Ministry of Corporate Affairs, Government of India, has set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI).

NFCG endeavours to build capabilities in the area of research in corporate governance and to disseminate quality and timely information to concerned

stakeholders. It works to foster partnerships with national as well as international organisations.

(ii) Organisation for Economic Co-operation & Development (OECD)

The Organisation for Economic Co-operation and Development (OECD) was established in 1961. The OECD was one of the first non-government organizations to spell out the principles that should govern corporates.

The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of all 30 countries that are members of the OECD. They were designed to assist governments and regulatory bodies in both OECD countries and elsewhere in drawing up and enforcing effective rules, regulations and codes of corporate governance. They also provide guidance for stock-exchanges, investors, companies and others that have a role in the process of developing good corporate governance.

(iii) Global Corporate Governance forum (GCGF)

The Global Corporate Governance Forum (the Forum) was founded in 2001 by the World Bank and the Organisation for Economic Co-operation and Development (OECD) following the financial crises in Asia and Russia in the latter part of the 1990's. It was established to promote initiatives to raise corporate governance standards and practices in developing countries and emerging markets, using the OECD Principles of Corporate Governance as the basis for its work.

(iv) Common Wealth Association of Corporate Governance (CACG)

The Commonwealth Association of Corporate Governance (CACG) was established in 1998 with the objective of promoting the best international standards on corporate governance throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development.

(v) International Corporate Governance Network (ICGN)

The International Corporate Governance Network ("ICGN") is a not-for-profit company limited by guarantee under the laws of England and Wales. The Network's mission is to develop and encourage adherence to corporate governance standards and guidelines, and to promote good corporate governance worldwide.

(vi) European Corporate Governance Institute (ECGI)

The European Corporate Governance Institute (ECGI) was founded in 2002. It has been established to improve corporate governance through fostering independent scientific research and related activities.

(vii) Conference Board

The Conference Board was established in 1916 in the United States of America. The Conference Board governance programs helps companies improve their

processes, inspire public confidence, and ensure they are complying with regulations.

(viii) Asian Corporate Governance Association (ACGA)

The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership organisation dedicated to working with investors, companies and regulators in the implementation of effective corporate governance practices throughout Asia.

(Note : Candidates may elaborate on any six forums.)

PART B

(Answer **ANY TWO** questions from this part)

Question 5

- (a) *“The code of conduct of each company summarises its philosophy of doing business.*

The exact details of this code are a matter of discretion, but there are some common principles in drafting of the code in most of the companies.” What are these principles ? (6 marks)

- (b) *Write short notes on any three of the following :*

- (i) *Activity analysis*
- (ii) *Code of ethics*
- (iii) *Deontological ethics*
- (iv) *Ethics in marketing.*

(3 marks each)

Answer 5(a)

Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

- Use of company’s assets;
- Avoidance of actions involving conflict of interest;
- Avoidance of compromising on commercial relationship;
- Avoidance of unlawful agreements;
- Avoidance of offering or receiving monetary or other inducements;
- Maintenance of confidentiality;
- Collection of information from legitimate sources only.
- Safety at workplace
- Maintaining and Managing Records
- Free and Fair competition
- Disciplinary actions

Answer 5(b)(i)**Activity Analysis**

The ethical dimension of an activity can be determined with the help of the following grid which is self-explanatory:

Activity Analysis
(Ethical)

Parasite	Win-win Situation
Helping self	Helping self
Injuring Others	Helping Others
Martyr	Total Loss
Helping Others	Injuring self
Injuring self	Injuring Others

The first block in the grid – help self and injuring others is obviously unethical. The second block that is helping others and injuring self may appear to be ethical, however it is not ethical. The third grid wherein one helps self and also helps others is the most ideal and ethical situation. The win-win situation. The last grid is a situation that should be avoided at all costs and is highly unethical.

Answer 5(b)(ii)

A **code of ethics** consists of general statements, sometimes altruistic or inspirational, that serve as principles and the basis for rules of conduct. A code of ethics generally specifies methods for reporting violations, disciplinary action for violations, and a structure of due process.

A code of ethics should reflect upper managers' desire for compliance with the values, rules, and policies that support an ethical climate. The development of a code of ethics should involve the president, board of directors, and chief executive officers who will be implementing the code. Legal staff should also be called on to ensure that the code has correctly assessed key areas of risk and that it provides buffers for potential legal problems.

Corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

Answer 5(b)(iii)

Deontological ethics or **deontology** (Greek: (deon) meaning 'obligation' or 'duty') is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions. Thus, the term 'deontological' picked out the set of ethical theories that are

based on the idea that an action's being right or wrong is basic and the determining factor, and whether a situation is good or bad depends on whether the action that brought it about was right or wrong. This can be clarified with an example – if a manager decides that it is his duty to always be on time to meetings is running late for reasons not in his control, how is he supposed to drive to reach the meeting on time? Is he supposed to speed, breaking his duty to uphold the law, or is he supposed to arrive at his meeting late, breaking his duty to be on time?

Answer 5(b)(iv)

Ethics in Marketing

Marketing ethics is the area of applied ethics which deals with the moral principles behind the operation and regulation of marketing. The ethical issues confronted in this area include :

- Pricing : price fixing, price discrimination, price skimming.
- Anti-competitive practices like manipulation of supply, exclusive dealing arrangements, tying arrangements etc.
- Misleading advertisements
- Content of advertisements.
- Children and marketing.
- Black markets, grey markets.

Question 6

- (a) *"A major step in developing an effective ethics programme is implementing a training programme and communication system to communicate and educate employees about the company's ethical standards." Elucidate. (5 marks)*
- (b) *What is 'ethics committee' ? Describe the functions of an ethics committee. (5 marks)*
- (c) *"There are four theses viewing stakeholders' theory." Describe and discuss. (5 marks)*

Answer 6(a)

Ethics Training and Communication

A major step in developing an effective ethics program is implementing a training program and communication system to communicate and educate employees about the firm's ethical standards.

Training can educate employees about the firm's policies and expectations, as well as relevant laws and regulations and general social standards. Training programs can make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice. They can also empower employees to ask tough questions and make ethical decisions. Many companies are now incorporating ethics training into their employee and management development training efforts.

If ethics training is to be effective, it must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program. Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics.

To be successful, business ethics programs should educate employees about formal ethical frameworks and more for analyzing business ethics issue. Then employees can base ethical decisions on their knowledge of choices rather than on emotions.

Answer 6(b)

Ethics Committee

Companies should have a committee of independent non-executive directors who are responsible for ensuring that systems are in place in the company to assure employee compliance with the Code of Ethics.

Functions of Ethics Committee

The oversight process of the Ethics Committee of an organization involves the following areas to be addressed by it:

Review of the definitions of standards and procedures

The Committee should review the organization's areas of operation, the activities that require a formal set of ethical standards and procedures.

Once the review is complete and any shortcomings have come to light the ethics committee should assign the creation of revised guidelines to the appropriate personnel including the design of a formal method for communicating standards and procedures to employees. This method should ensure that employees both understand and accept the ethics program.

The ethics committee can suggest behaviors to upper management that reinforce the organization's guidelines.

Facilitate Compliance

The ethics Committee has the responsibility for overall compliance. It is the responsible authority for ethics compliance within its area of jurisdiction. It should serve as the court of last resort concerning interpretations of the organization's standards and procedures. When and if inconsistencies come to light in this manner, the committee should make recommendations on improving the existing compliance mechanisms. And, as always, there should be follow-up to ensure that compliance recommendations have been understood and accepted.

Due diligence of prospective employees

The ethics committee should define how the organization will balance the rights of individual applicants and employees against the organization's need to avoid risks that come from placing known violators in positions of discretionary responsibility. This includes

the oversight of background investigations on employees/applicants who are being considered for such positions.

Oversight of communication and training of ethics programme

The ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of conduct, for example) to ensure that every employee understands and accepts the organization's ethical guidelines. To make certain that published standards are understood, the ethics committee should provide regular training sessions as well.

Since communication is two-way, the ethics committee should solicit stakeholder input regarding how standards and procedures are defined and enforced. In this connection, it is useful to create ways of providing proof that each employee has received the appropriate documents and understands the standards and procedures described.

Monitor and audit compliance

Compliance is an ongoing necessity and the ethics committee should design controls which monitor, audit and demonstrate employees' adherence to published standards and procedures. There should also be mechanisms which check the effectiveness and reliability of such internal controls.

To warrant that the organization's goals, objectives and plans do not conflict with its ethical standards and procedures, the ethics committee should develop methods for regular review and assessment.

Enforcement of disciplinary mechanism

Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures (as against applying different standards to different employees based on their position, performance, function, and the like). There should be provisions for those who ignore as well as those who violate standards and procedures.

Analysis and follow-up

When violations occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chance that similar violations takes place in future.

Answer 6(c)

There are four theses viewing stakeholder theory:

1. *Descriptive* : The Corporation is viewed as an assemblage of co-operative and competitive interests possessing intrinsic value. The theory is used to describe specific corporate characteristics such as nature of the firm, the way managers think about managing, how corporations are managed, or how the board members think about the interests of constituencies.

Descriptive stakeholders are defined as to whether they are affected by the firm and/or can potentially affect the firm.

2. *Instrumental* : This approach establishes a framework of examining ceteris paribus

connections, between the practice of stakeholder management and achievement of corporate performance goals. If you want to achieve (avoid) results_____, then adopt (don't adopt) principles & practices.....

Instrumental stakeholders are defined by the need of the management to take them into account when trying to achieve their goals.

3. *Normative* : The identification of moral or physical guidelines for the management of corporations. This approach is categorical in effect it says—'Do (don't do) this because it is the right (wrong) thing to do' .

Normative stakeholders have a valid normative claim on the firm.

4. *Broadly managerial* : It recommends attitudes, structures and practices that taken together constitute stakeholder management. Stakeholder management requires, as it key attribute, simultaneous attention to legitimate interests of all appropriate stakeholders, both in the establishment of organization structures and general policies.

Question 7

- (a) *Explain the Clarkson Principles of Stakeholders' Management.* (5 marks)
- (b) *"The ethical tendency or climate of an organisation is set at the top." In the light of this statement, critically examine the role of Board of directors in the ethical climate of a company.* (5 marks)
- (c) *"Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders and to improve performance of all aspects, viz., social, environmental and economic." Explain and discuss briefly the principles of social and ethical accounting.* (5 marks)

Answer 7(a)

The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics:

Principle 1 : Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2 : Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3 : Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4 : Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

Principle 5 : Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6 : Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 7(b)

The board of directors hold the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions. As has been stated earlier the ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. The directors on a company's board assume legal responsibility for the firm's resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company's approach towards ethical issues and stakeholder interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

Answer 7(c)

Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the development of policies and performance targets and to the assessment and communication of performance.

The dominant principle of social and ethical accounting is inclusivity. This principle

requires that the aspirations and needs of all stakeholder groups are taken into account at all stages of the social and ethical accounting process.

- *Planning* : The company commits to the process of social and ethical accounting, auditing and reporting, and defines and reviews its values and social and ethical objectives and targets.
- *Accounting* : The scope of the process is defined, information is collated and analysed, and performance targets and improvement plans are developed.
- *Reporting* : A report on the company's systems and performance is prepared.
- *Auditing* : The process of preparing the report and the report itself are externally audited, and the report is made accessible to stakeholders in order to obtain feedback from them.
- *Embedding* : To support each of the stages, structures and systems are developed to strengthen the process and to integrate it into the company's activities.
- *Stakeholder engagement* : The concerns of stakeholders are addressed at each stage of the process through regular involvement.

PART C

Question 8

Attempt any four of the following :

- (i) *Write a note on 'sustainability reporting in emerging economies'.*
- (ii) *Discuss the fundamental principles of sustainable development. How are these principles related to United Nations Conference on Environment and Development (UNCED), 1992 held at Rio de Janeiro ?*
- (iii) *What is the 'global compact' ? What are the objectives of this initiative?*
- (iv) *What is difference between 'convention' and 'protocol' ? Discuss briefly the major features of Kyoto Protocol. How was the implementation of Kyoto Protocol accorded ?*
- (v) *The Supreme Court of India has shown its concern about the discharge of untreated effluents into the rivers in many cases. Discuss the problem of water pollution in India and court's initiatives for its protection in the light of decided case law.* (5 marks each)

Answer 8(i)

Investors increasingly recognize the value of robust sustainability reporting and expectations for such reporting have spread to companies in emerging markets. While it may be difficult for emerging market companies to devote the resources to such reporting and companies should begin by taking the first step, committing to the process of reporting, and demonstrating that they are managing the sustainability issues most material to their sector. Such companies will develop a competitive advantage in the marketplace and reach a greater range of investors and customers.

Increasingly global companies understand that a commitment to sustainability reporting can contribute to financial success. Such transparency allows companies to reach a broader range of investors and customers, enhance operational efficiency, improve brand positioning, and develop leadership in the marketplace.

Answer 8(ii)

Four fundamental Principle of Sustainable Development agreed by the world community are:

1. *Principle of Intergenerational equity* : need to preserve natural resources for future generation.
2. *Principle of sustainable use* : use of natural resources in a prudent manner without or with minimum tolerable impact on nature.
3. *Principle of equitable use or intergenerational equity* : Use of natural resources by any state / country must take into account its impact on other states.
4. *Principle of integration* : Environmental aspects and impacts of socio-economic activities should be integrated so that prudent use of natural resources is ensured.

This was reinforced at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in 1992. It is now universally acknowledged that the present generation has to ensure that the people coming ahead, the generations still unborn, have a world no worse than ours and hopefully better.

Answer 8(iii)

The UN Global Compact presents a unique and powerful platform for participants to advance their commitments to sustainability and corporate citizenship. More than 5200 company are participants and has stakeholders from more than 120 countries, over 60 networks in developed and emerging economies.

The Global Compact is a voluntary corporate citizenship initiative with two objectives:

“Making the Global Compact and its principles part of business strategy and operations.”

“Facilitating cooperation among key stakeholders and promoting partnerships in support of U.N. goals.”

Answer 8(iv)

The Kyoto Protocol, adopted at the third Conference of the Parties to the UNFCCC (COP 3) in Kyoto, Japan, in 1997 came into force in 2005, is an international agreement linked to the United Nations Framework Convention on Climate Change. The major feature of the Kyoto Protocol is that it sets binding targets for 37 industrialized countries and the European community for reducing greenhouse gas (GHG) emissions. These amount to an average of five per cent against 1990 levels over the five-year period 2008-2012.

The major distinction between the Protocol and the Convention is that while the Convention encouraged industrialised countries to stabilize GHG emissions, the Protocol commits them to do so.

The Protocol requires developed countries to reduce their GHG emissions below levels specified for each of them in the Treaty. These targets must be met within a five-year time frame between 2008 and 2012, and add up to a total cut in GHG emissions of at least 5% against the baseline of 1990.

The Kyoto Protocol is generally seen as an important first step towards a truly global emission reduction regime that will stabilize GHG concentrations at a level which will avoid dangerous climate change. As a result of the Protocol, governments have already put, and are continuing to put legislation and policies in place to meet their commitments; a carbon market has been created; and more and more businesses are making the investment decisions needed for a climate-friendly future. The Protocol provides the essential architecture for any new international agreement or set of agreements on climate change. The first commitment period of the Kyoto Protocol expires in 2012.

The detailed rules for the implementation of the Protocol were adopted at COP 7 in Marrakesh in 2001, and are called the “Marrakesh Accords.”

Answer 8(v)

Water Pollution

Leather industry is one of the three major industries besides paper and textiles, consuming large quantities of water for processing of hides and skins into leather. Naturally most of the water used is discharged as waste water containing putrescible organic and toxic inorganic materials which when discharged as such will deplete dissolved oxygen content of the receiving water courses resulting in the death of all aquatic life and emanating foul odour. The *M.C. Mehta v. Union of India* [AIR 1988 SC 1037] also known as the Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court as evidence.

“Where in public interest litigation owners of some of the tanneries discharging effluents from their factories in Ganga and not setting up a primary treatment plant in spite of being asked to do so for several years did not care, in spite of notice to them, even to enter appearances in the Supreme Court to express their willingness to take appropriate steps to establish the pre-treatment plants it was held that so far as they were concerned on order directing them to stop working their tanneries should be passed. It was observed that the effluent discharged from a tannery is ten times noxious when compared with the domestic sewage water which flows into the river from any urban area on its bank. It was further observed that the financial capacity of the tanneries should be considered as irrelevant while requiring them to establish primary treatment plants. Just like an industry which cannot pay minimum wages to its worker cannot be allowed to exist, a tannery which cannot set up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effect on the public at large which is likely to ensue by the discharging of the trade effluents from the tannery to the river Ganga would be immense and it will outweigh any inconvenience that may be caused to the management and the labour employed by it on account of its closure”.

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

*(Answer Question No. 1 which is compulsory
and any two of the rest from this part)*

Question 1

- (a) *"The controlled mis-governance is a type of fraud that is perpetrated by the person(s) running the company. In such situations, the management deceptively leads all the stakeholders to believe that the company is being run superbly successfully, while in reality it is led to bankruptcy." With reference to the statement, examine the issues and challenges in Corporate Governance citing relevant case(s) of corporate scams. (10 marks)*
- (b) *State, with reasons in brief, whether the following statements are true or false :*
- (i) *Insurance is a method of risk avoidance.*
 - (ii) *Insider may not simply steal the earnings.*
 - (iii) *Remuneration committee is constituted to determine the remuneration of CEO only.*
 - (iv) *In terms of Clause 49 of the listing agreement, 'related party transactions' are prohibited.*
 - (v) *Internal control plays an important role in preventing and detecting fraud and protecting the organisation's resources. (2 marks each)*

Answer 1(a)

Controlled misgovernance is a type of fraud that is perpetrated by the person(s) running the company. In such a situation the management deceives all the stakeholders into believing that they run a superbly successful business but in reality it is heading towards bankruptcy. It then becomes impossible for us to believe that the governance of firm could have duped all its stakeholders.

But that is how controlled misgovernance is expected to unfold in the days to come. The grossly inflated numbers in the financial statements are backed by documentation that makes outside auditors to rely on them which in turn provide the cover of apparent neutrality for the perpetrators of the fraud. So, in such a scenario the regulators and independent directors instead of defending the interests of the investors end up advocating the interest of the management. When the fraud unfolds auditors often seek reduced liability.

The Satyam case misgovernance highlighted the lack of independent director's interest in the Board processes, they did not play their role in efficient manner and the consequences proceeded. The mere meeting of criteria of independence does not ensure that an independent director is acting independently. They should play a vigilant role by

attending the meetings, studying and analysing the agenda papers, ask the right questions at the right time, insist that dissent if any is recorded, and have separate sessions of independent directors and act with integrity.

On the other hand the auditors in this case have tried to distance themselves from the fraud perpetrated by the management by issuing a statement that “The representations made by the Chairman and other management to the auditors during the audit now appear to be false and, therefore, are no longer reliable.”

Some issues and challenges that need scrutiny are:

(i) *Role of Independent directors*

Independent directors are known to bring an objective view in board deliberations. They are required to ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They should act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict. Independent Directors bring a valuable outside perspective to the deliberations.

(ii) *Role of independent directors in audit committee*

Independent directors' play a crucial role in Audit Committee. The audit committee is responsible to ensure the integrity of financial reporting, therefore, each independent director who is a member of audit committee should be able to read and understand financial statements.

(iii) *Tenure of independent directors*

Excessively long tenure of independent directors may compromise their independence. On being associated for a long period with a company, there is a strong likelihood that independent directors lose their objectivity. Clause 49 does specify as a non-mandatory requirement that the maximum term should not exceed nine years.

(iv) *Flow of information to the board*

Companies should ensure that timely, relevant and complete information is made available to independent directors so that they are able to make informed decisions. The independent directors on their part should also question and seek clarifications whenever in doubt.

(v) *Recording of dissent*

It is important that where an independent director is not in agreement with the decision of the majority, he should insist that his dissent be recorded.

(vi) *Role of Auditor*

Auditors are expected to work with and not against management, while always remaining professionally objective - that is to say, applying their professional skills impartially and retaining a critical detachment and a consciousness of their accountability to those who formally appoint them. Maintaining such a professional and objective relationship is the responsibility both of boards of

directors and of auditors, as is that of taking appropriate action if the basis for that relationship no longer holds.

Audits are a reassurance to all who have a financial interest in companies, quite apart from their value to boards of directors. The role of the auditors is not just to go by the numbers presented in the accounts and sign off bogus accounts rather they need to verify the facts presented by the company.

Even if there is a remotest possibility that this may indeed be the case then it must show the way forward for auditors to directly interact with the banks and other institutions to obtain the required confirmation and for the independent directors to play a major role in effective oversight body to hold the management accountable to the shareholders.

Answer 1(b)(i)

False

It is not a method of risk avoidance rather it is risk transfer. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses that might arise on the occurrence of a specified peril. Insurance does not protect a firm against all perils but it offers restoration, at least in part of any resultant economic loss.

Answer 1(b)(ii)

True

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, define that "Insider" is any person, who is or was connected with the company, and who is reasonably expected to have access to unpublished price-sensitive information about the stock of that particular company, or who has access to such unpublished price sensitive information.

Answer 1(b)(iii)

False

Remuneration Committee or Compensation Committee is constituted by a company to determine the remuneration packages of directors including chief executive officers.

Answer 1(b)(iv)

False

Clause 49 does not prohibit 'related party transactions' rather it provides for review of related party transaction by Audit Committee and its disclosure.

Answer 1(b)(v)

True

The system of internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists in compliance with laws and regulations. They help to ensure that a company is not

unnecessarily exposed to avoidable financial risks and that the financial information used within the business and for publication is reliable. They also contribute to the safeguarding of assets, including the prevention and detection of frauds.

Question 2

(a) Write short notes on any three of the following :

- (i) CEO/CFO certification
 - (ii) Relationship between directors and managers
 - (iii) Task force on corporate excellence through governance
 - (iv) Corporate philanthropy and corporate social responsibility (CSR).
- (3 marks each)

(b) Describe the tools used by the institutional investors to assess the health of a company before investing resources in it. (6 marks)

Answer 2(a)(i)

Clause 49 of the Listing Agreement requires that the CEO, i.e., the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that to the best of their knowledge:

- (a) the financial statements and the cash flow statement reviewed by them do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading and that they present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) no transactions entered into by the company during the year are fraudulent, illegal or violative of the company's code of conduct.
- (c) They have indicated to the auditors and the Audit Committee of any significant changes in internal control, accounting policies over financial reporting during the year or any instances of significant fraud of which they have become aware and the involvement therein;

Answer 2(a)(ii)

Directors and managers need to work together based on mutual respect, trust and commitment. A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization's effectiveness. The Executive Management can help the board govern more and manage less by adopting the following three methods:

- Use a comprehensive strategic plan that has been developed in conjunction with the board, and supplement it with regular progress reports. This will keep the board's sights focused on the long term goals and mission of the organization. Regular reports will keep board members apprised of progress toward organizational goals, and provide part of the basis for evaluation of the executive management.

- Provide the board with relevant materials before board meetings, and explain why the materials are coming to the attention of the board. Let board members know how specific agenda items relate to the organization's larger mission, and what kind of action or discussion is desired of the board on each item.
- Facilitate board and board committee discussions so that the board stays focused on the larger issues. Refer to set policies that define the limits of the board's decision-making power, and strive to engage the board in a dialogue among themselves that leads to consensus-building.

Answer 2(a)(iii)

In November 2000, a Task Force on Corporate Excellence set up by the group under the chairmanship of Dr. P.L. Sanjeev Reddy, Secretary, DCA (now MCA) produced a report containing a range of recommendations for raising governance standards among all companies in India. The group examined ways to “operationalise the concept of corporate excellence on a sustained basis”, so as to “sharpen India’s global competitive edge and to further develop corporate culture in the country”.

A Summary of Report of Task Force:

1. Higher delineation of independence criteria and minimization of interest-conflict potential.
2. Directorial commitment and accountability through fewer and more focussed board and committee membership.
3. Meaningful and transparent accounting and reporting, improved annual report along with more detailed filing with regulatory authorities.
4. Setting up of an independent, Autonomous Centre for Corporate Excellence to accord accreditation and promote policy research and studies, training and education, etc., in the field of corporate excellence through improved corporate governance.
5. Introducing formal recognition of Corporate Social Responsibility.
6. Clear distinction between two basic components of governance in terms of policy making and oversight responsibilities of the board of directors.
7. Apply the highest and toughest standards of corporate governance to Listed companies.
8. PSUs be relieved from multiple surveillance agencies and simultaneously a commission be appointed to draft a suitable code of public behaviour.

Answer 2(a)(iv)

Difference between CSR and Philanthropy/Charity

Corporate Social Responsibility is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/ or planet issues. CSR initiatives of a corporate is not a selfless act of giving;

companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

On the other hand, philanthropy means the act of donating money, goods, time or effort to support a charitable cause with regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

The Etymological origin of the word is from Late Latin philanthropia, from Greek philanthropia, from philanthropos loving people that is phil- + anthropos human being. It is the active effort to promote human welfare.

Answer 2(b)

Institutional investors remain alert while investing in a company; they assess the health of company before investing resources in it. Following are the tools used by Institutional Investors

(i) *One-to-one meetings*

The meetings between institutional investors and companies are extremely important as a means of communication between the two parties.

(ii) *Voting*

The right to vote which is attached to voting shares is a basic prerogative of share ownership, and is particularly important given the division of ownership (shareholders) and control (directors) in the modern corporation. The right to vote can be seen as fundamental tools for some element of control by shareholders. The institutional investors can register their views by postal voting, or, vote electronically where this facility is available.

(iii) *Focus lists*

A number of institutional investors have established 'focus lists' whereby they target underperforming companies and include them on a list of companies which have underperformed a main index, such as Standard and Poor's. After being put on the focus list, the companies often receive unwanted attention of the institutional investors who may seek to change various directors on the board.

(iv) *Corporate governance rating systems*

A number of corporate governance rating systems come up with the development of corporate governance. Examples of such firms which have developed corporate governance rating systems are Deminor, Standard and Poor's, and Governance Metrics International (GMI). The ratings will also be useful to governments in identifying perceived levels of corporate governance in their country compared to other countries in their region, or outside it, whose companies may be competing for limited foreign investment. A corporate governance rating could be a powerful indicator of the extent to which a company currently is adding, or has the potential

to add in the future, shareholder value. This is because a company with good corporate governance is generally perceived as more attractive to investors than one without.

Question 3

- (a) *"The Global Corporate Governance Forum's mandate is to promote global, regional and local initiatives that improve Corporate Governance policy standards and practices in developing countries." Elucidate this statement. (5 marks)*
- (b) *"To enable better and more focused attention on the affairs of the company, the Board delegates particular matters to committees of the Board set-up for the purpose but the ultimate responsibility lies with the Board." In the light of the statement, discuss the need and advantages of committee management. (5 marks)*
- (c) *What is 'risk retention' ? Distinguish between 'risk retention' and 'risk transfer'. (5 marks)*

Answer 3(a)

The Global Corporate Governance Forum (the Forum) was founded in 2001 by the World Bank and the Organisation for Economic Co-operation and Development (OECD) following the financial crises in Asia and Russia in the latter part of the 1990's. It was established to promote initiatives to raise corporate governance standards and practices in developing countries and emerging markets, using the OECD Principles of Corporate Governance as the basis for its work.

The Forum's mandate is to promote global, regional and local initiatives that improve corporate governance policy standards and practices in developing countries. The Forum focuses on the following four areas:

- (a) raising awareness and building consensus for implementation of reform through meetings, briefings, policy papers, and conferences;
- (b) sponsoring research relevant to the needs of developing countries to underpin reform efforts by sound analysis through sponsoring papers and building sustainable networks for academics in developing countries;
- (c) disseminating best practice materials and publications and guidelines developed with leading global specialists and practitioners; and
- (d) supporting institution and capacity building and providing technical assistance to ensure implementation at the field level through training programs, toolkits and other direct assistance.

Answer 3(b)

With the globalization the regulatory requirements have become more complex and the onus on the board is immense. In this scenario the need to delegate oversight to a board committee has become imperative.

To enable better and more focused attention on the affairs of the company, the board delegates particular matters to committees of the board set up for the purpose however the ultimate responsibility lies with the board.

Advantages of Board Committee Management

Committees allows the board to

- Handle a greater number of issues with greater efficiency by having experts focus on specific areas.
- Develop subject specific expertise on areas such as compliance management, risk management, financial reporting.
- Enhance the objectivity and independence of the board's judgment.

Greater specialization and intricacies of modern board work is one of the reasons for increased use of board committees. The reasons include:

- Responsibilities are shared.
- More members become involved.
- Specialized skills of members can be used to best advantage.
- Inexperienced members gain confidence while serving on the committee.
- Matters may be examined in more detail by a committee

The committees focus accountability to known groups. While the board as a legal unit always retains responsibility for the work of its Committees, the committee because of its focus on the mandate, the size of the committee being relatively smaller than the Board tend to be more effective.

Answer 3(c)**Risk Retention**

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

- (i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.
- (ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

Risk Transfer

This refers to legal assignment of cost of certain potential losses to another. The insurance of 'risks' is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz., (i) By Tort (ii) By contract other than insurance (iii) By contract of insurance. The main method of risk transfer is insurance. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses arising from the occurrence of a specified peril. Thus, insurance substitutes certainty for uncertainty. Insurance does

not protect a firm against all perils but it offers restoration, atleast in part of any resultant economic loss.

Question 4

- (a) *Elaborate the provisions in respect of the composition of audit committee under the following :*
- (i) *Listing agreement as prescribed by SEBI.*
 - (ii) *NYSE listing rules.*
 - (iii) *Section 292A of the Companies Act, 1956.* (3 marks each)
- (b) *Discuss the background stating some case laws, which brought about the development of insider trading law.* (6 marks)

Answer 4(a)(i)

Composition of Audit Committee under Listing Agreement

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation 1 : The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2 : A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3. The Chairman of the Audit Committee shall be an independent director;
4. The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
5. The Company Secretary shall act as the secretary to the committee.

Answer 4(a)(ii)

Composition of Audit Committee under NYSE Rules

- The audit committee must have a minimum of three members.
- All the members of the Audit Committee must be independent

- Each member of the audit committee must be financially literate, as such qualification is interpreted by the company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee.
- In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.

Answer 4(a)(iii)**Section 292A of Companies Act 1956**

The Committee shall consist of at least three directors and such number of other directors as the Board may determine. Two-thirds of the total number of members of the committee shall be directors other than managing or whole time directors. Members of the committee shall elect a chairman from amongst themselves. The Annual Report of the Company shall disclose the composition of the Audit Committee.

The auditors, the internal auditor, if any, and the director-in charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Answer 4(b)

Much of the development of insider trading law has resulted from court decisions.

In *SEC v. Texas Gulf Sulphur Co.* (1966) (U.S.A), a federal circuit court stated that anyone in possession of inside information must either disclose the information or refrain from trading.

In *United States v. Carpenter* (1986) the U.S. Supreme Court cited an earlier ruling while unanimously upholding mail and wire fraud convictions for a defendant who received his information from a journalist rather than from the company itself. The journalist R. Foster Winans was also convicted, on the grounds that he had misappropriated information belonging to his employer, the Wall Street Journal. In that widely publicized case, Winans traded in advance of "Heard on the Street" columns appearing in the Journal.

The court ruled in *Carpenter*: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principle for any profits derived there from."

The misuse is subject to varying interpretations. The insider-trading allegation against Hindustan Lever (HLL) for purchasing eight lakh shares of Brooke Bond Lipton India (BBLIL) from Unit Trust of India a month before the merger of the two companies was announced is a case in point.

HLL appealed against SEBI's order to the Appellate Authority of the Finance Ministry claiming that a company cannot be an insider to itself and that the shares were bought solely with the intent of preserving the parent company, Unilever's 51 per cent stake in HLL. It was further argued that the reports on the HLL and BBLIL merger had already

been published by various entities. So it was not acting on undisclosed or unpublished information.

SEBI the Market regulator has put in place a comprehensive Integrated Market Surveillance System to track trading data from all the market participants stock exchanges, depository participants, custodians as well as data of clearing houses.

PART B

(Answer ANY TWO questions from this part)

Question 5

- (a) *Most of the companies begin the process of establishing organisational ethics programme by developing codes of conduct. What are the core values or principles contained in these codes of conduct ? Briefly discuss the legal provisions in respect of codes of conduct in India and USA. (6 marks)*
- (b) *Write short notes on any three of the following :*
- (i) *Ethics in production*
 - (ii) *The Caux Round Table*
 - (iii) *Virtue ethics theory*
 - (iv) *Characteristics of ethical decisions. (3 marks each)*

Answer 5(a)

Codes of conduct are formal statements that describe what an organization expects of its employees. Such statements may take three different forms a code of ethics, a code of conduct, and a statement of values.

Corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

In India, Clause 49 of the Listing Agreement requires that

- (i) The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.
- (ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

Explanation : For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

In the United States of America, Section 406 of the Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have codes of ethics and also to disclose any waivers of those codes for certain members of senior management.

Section 406(a) of Regulation S-K requires companies to disclose:

- whether they have a written code of ethics that applies to their principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions;
- any waivers of the code of ethics for these individuals; and
- any changes to the code of ethics.

If companies do not have a code of ethics, they must explain why they have not adopted one. A company may either file its code as an exhibit to the annual report, post the code on the company's Web site or agree to provide a copy of the code upon request and without charge.

Answer 5(b)(i)

Ethics of Production

This area of business ethics deals with the duties of a company to ensure that products and production processes do not cause harm. Some of the more acute dilemmas in this area arise out of the fact that there is usually a degree of danger in any product or production process and it is difficult to define a degree of permissibility, or the degree of permissibility may depend on the changing state of preventative technologies or changing social perceptions of acceptable risk.

- Defective, addictive and inherently dangerous products and
- Ethical relations between the company and the environment include pollution, environmental ethics, carbon emissions trading
- Ethical problems arising out of new technologies for eg. Genetically modified food
- Product testing ethics.

The most systematic approach to fostering ethical behavior is to build corporate cultures that link ethical standards and business practices.

Answer 5(b)(ii)

The Caux Round Table

The Caux Round Table (CRT) is based on the belief that the world business community should play an important role in improving economic and social conditions. As a statement of its aspirations, it developed a document that aims to express a world standard against which business behavior can be measured.

The CRT Principles for Business were formally launched in 1994, and presented at the United Nations World Summit on Social Development in 1995. The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. The CRT Principles for Business emerged from a series of dialogues catalyzed by the Caux Round Table during the late 1980's and early 1990's. The Principles are comprehensive statement of responsible business practice formulated by business leaders for business leaders.

Answer 5(b)(iii)

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen article.

Answer 5(b)(iv)

According to Sueanne, in her book *Ethical Dilemma, Characteristics and Theory* (2008) states characteristics of ethical decisions which are enumerated as under:

Most Ethical Decisions Have Mixed Outcomes – “It is commonly thought that ethical issues in management are largely antithetical, with directly opposed financial returns and social costs. The antithetical model for outcome evaluation presents ethical issues in sharp focus but it does not accurately portray the managerial dilemma. Social benefits and cost as well as financial revenues and expenses are associated with almost all of the alternative in ethical choices.”

Most Ethical Decisions Have Personal Implications – “Most ethical decisions have personal implications. It is commonly thought that ethical issues in management are largely impersonal, divorced from the lives and careers of the managers. Many people believe that *prima facie* ethical decisions in a given operation may reduce the profits of the company but not the executives’ salaries or their opportunities for promotion.”

Most Ethical Decisions Have Multiple Alternatives – “It is commonly thought that ethical issue in management are primarily dichotomous, a “yes” or a “no” choice, with no other alternatives.”

Most Ethical Decisions Have Extended Consequences – “The results of managerial decisions and actions do not stop with first-level consequences. Rather, they extend throughout society, and extension constitutes the essence of the ethical argument: the decisions of managers have an impact upon others, both within the organization and within the society. The impact is beyond their control; hence, they should be seriously considered when decisions are made by managers.”

Most Ethical Decisions Have Uncertain Consequences – “It is commonly thought that ethical issues in management are free of risk and doubt, with a known outcome for each alternative. A deterministic model-that is, one without probabilities-simplifies the process of analysis, but it does accurately describe the managerial dilemma. It is not clear what consequences would follow...”

Question 6

- (a) “Writing a code of conduct, supporting it at top levels and communicating it to employees is just a beginning. Companies should have an ethics committee comprising of independent non-executive directors.” Enumerate the statement and state the functions of ethics committee. (5 marks)
- (b) Discuss the ‘stakeholder concept’ stating the principles enunciated by Evans and Freeman. (5 marks)

- (c) *What are the challenges of business ethics ? What are the two control systems that can be embodied in an ethics programme ?* (5 marks)

Answer 6(a)

Codes of conduct need to be living documents that are encouraged and valued at the highest levels. Board members and senior executives have to set an example for the type conduct they expect from others. Ethical lapses at the higher levels of management tend to be perceived as tacit permission to commit lapses at lower levels. Senior management needs to hold itself to the highest standards of conduct before it can demand similar integrity from those at lower levels.

Companies should have a committee of independent non-executive directors who are responsible for ensuring that systems are in place in the company to assure employee compliance with the Code of Ethics.

Functions of Ethics Committee

The oversight process of the Ethics Committee of an organization involves the following areas to be addressed by it:

Review of the definitions of standards and procedures

The Committee should review the organization's areas of operation, the activities that require a formal set of ethical standards and procedures.

Once the review is complete and any shortcomings have come to light the ethics committee should assign the creation of revised guidelines to the appropriate personnel including the design of a formal method for communicating standards and procedures to employees. This method should ensure that employees both understand and accept the ethics program.

The ethics committee can suggest behaviors to upper management that reinforce the organization's guidelines.

Facilitate Compliance

The ethics Committee has the responsibility for overall compliance. It is the responsible authority for ethics compliance within its area of jurisdiction. It should serve as the court of last resort concerning interpretations of the organization's standards and procedures. When and if inconsistencies come to light in this manner, the committee should make recommendations on improving the existing compliance mechanisms. And, as always, there should be follow-up to ensure that compliance recommendations have been understood and accepted.

Due diligence of prospective employees

The ethics committee should define how the organization will balance the rights of individual applicants and employees against the organization's need to avoid risks that come from placing known violators in positions of discretionary responsibility. This includes the oversight of background investigations on employees/applicants who are being considered for such positions.

Oversight of communication and training of ethics programme

The ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of

conduct, for example) to ensure that every employee understands and accepts the organization's ethical guidelines. To make certain that published standards are understood, the ethics committee should provide regular training sessions as well.

Since communication is two-way, the ethics committee should solicit stakeholder input regarding how standards and procedures are defined and enforced. In this connection, it is useful to create ways of providing proof that each employee has received the appropriate documents and understands the standards and procedures described.

Monitor and audit compliance

Compliance is an ongoing necessity and the ethics committee should design controls which monitor, audit and demonstrate employees' adherence to published standards and procedures. There should also be mechanisms which check the effectiveness and reliability of such internal controls.

To warrant that the organization's goals, objectives and plans do not conflict with its ethical standards and procedures, the ethics committee should develop methods for regular review and assessment.

Enforcement of disciplinary mechanism

Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures (as against applying different standards to different employees based on their position, performance, function, and the like). There should be provisions for those who ignore as well as those who violate standards and procedures.

Analysis and follow-up

When violations occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chance that similar violations takes place in future.

Answer 6(b)

In a business context, customers, investors and shareholders, employees, suppliers, government agencies, communities, and many others who have a "stake" or claim in some aspect of a company's products, operations, markets, industry, and outcomes are known as stakeholders. These groups are influenced by business, but they also have the ability to affect businesses.

Freeman defined stakeholder as 'any group or individual who can affect or is affected by the achievement of the organization's objectives'. This concept was elaborated by Evans & Freeman as the following two principles:

1. *Principles of corporate legitimacy*

The corporation should be managed for the benefit of its stakeholders: its customers, suppliers owners, employees & local communities. The rights of these groups must participate, in some sense, in decisions that substantially affect their welfare.

2. *The stakeholder fiduciary principle*

Management bears a fiduciary relationship to stakeholders and to the corporation

as an abstract entity. It must act in the interest of the stakeholders as their agent, and it must act in the interests of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of each group.

Subsequently Freeman redefined stakeholder as "Those groups who are vital to the survival & success of the corporation" and the principles were altered renamed:

1. *The stakeholder enabling Principle* - Corporations shall be managed in the interest of stakeholders.
2. *The Principle of Director Responsibility* - Directors of a corporation shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the stakeholder enabling principle.

Answer 6(c)

Organizations have ethics programme as a way of minimizing the risk of ethical misconduct or wrongdoing by employees. These programmes consist of policies, processes and education and training initiatives that explain the company's business ethics. These programmes clarify how ethics should translate into operating procedures and workplace behaviour. The focus of ethics programmes is compliance and is focused on rules and regulations.

A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate.

Two types of control systems can be created.

Compliance Orientation Programme : A compliance orientation creates order by requiring that employees identify with and commit to specific required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for noncompliance.

Values Orientation: *Values Orientation* strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of ideals such as respect and responsibility. Instead of relying on coercion, the company's values are seen as something to which people willingly aspire.

Question 7

- (a) *"Dilemma is a situation that requires a choice between options that are seen equally unfavourable or mutually exclusive". In the light of this statement, elaborate the ethical dilemma. State the steps to resolve an ethical dilemma.*
(5 marks)
- (b) *Explain the concept of 'whistle blower'. How should a company evolve its whistle blower policy ?*
(5 marks)
- (c) *How do good business ethics practices help in attracting and retaining talent in the organisation and achieve customer satisfaction ?*
(5 marks)

Answer 7(a)

Dilemma is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive.

An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing to do. Ethical dilemmas make individuals think about their obligations, duties or responsibilities. These dilemmas can be highly complex and difficult to resolve. Easier dilemmas involve a 'right' versus 'wrong' answer; whereas, complex ethical dilemmas involve a decision between right and right.

Steps to Resolving an Ethical Dilemma are as follows:

1. *What are the options ?*
List the alternative courses of action available.
2. *Consider the consequences*
Think carefully about the range of positive and negative consequences associated with each of the different paths of action available.
 - Who/what will be helped by what is done?
 - Who/what will be hurt?
 - What kinds of benefits and harms are involved and what are their relative values ?
 - What are the short-term and long-term implications?
3. *Analyse the actions*
Actions should be analysed in a different perspective i.e. viewing the action per se disregard the consequences, concentrating instead on the actions and looking for that option which seems problematic.
4. *Make decision and act with commitment*
Now, both parts of analysis should be brought together and a conscious and informed decision should be made. Once the decision is made, act on the decision assuming responsibility for it.
5. *Evaluate the system*
Think about the circumstances which led to the dilemma with the intention of identifying and removing the conditions that allowed it to arise.

Answer 7(b)

A **whistleblower** is a person who publicly complains concealed misconduct on the part of an organization or body of people, usually from within that same organisation. This misconduct may be classified in many ways; for example, a violation of a law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations, and corruption. Whistleblowers frequently are likely to face retaliation - sometimes at the hands of the organisation or group which they have accused unless a system is in place that would ensure confidentiality is maintained. It is in this context whistleblowers are often protected under law from employer retaliation.

In India, clause 49 of the Listing Agreement provides as under with regard to Whistle Blower Policy:

Whistle Blower Policy

The company may establish a mechanism for employees to report to the

management, concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail this and also provide direct access to the chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. This is a non-mandatory requirement. In case the whistle Blower mechanism is existing, the audit committee is responsible to review the functioning of the Whistle Blower mechanism.

Answer 7(c)

Retaining talent

People aspire to join organization with high ethical values. The ethical climate matter to the employees. Ethical organizations create an environment that is trustworthy, making employees willing to rely, take decisions and act on the decisions and actions of the co-employees. In such a work environment, employees can expect to be treated with respect and consideration by their colleagues and superiors. It cultivates strong teamwork and productivity and support employee growth.

Retaining talented people is as big a challenge as getting them in the first place. Work is a means to an end for them, not an end in itself. The relationship employees have with their employer must be a mutual, win-win one, in which their loyalty should not be taken for granted. Talented people will invest their energy and talent only in organizations with values and beliefs that match their own. In order to achieve this match, managers need to build cultures, compensation and benefits packages, and career paths that reflect and foster certain shared values and beliefs.

Customer satisfaction

Customer satisfaction is a vital factor in successful business strategy. Repeat purchases/orders and enduring relationship of mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company that adopts ethical practices. When a company because of its belief in high ethics is perceived as such, any crisis or mishaps along the way is tolerated by the customers as a minor aberration. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified ensuring that organizational behaviors are aligned with those values. An organization with a strong ethical environment places its customers' interests as foremost. Ethical conduct towards customers builds a strong competitive position. It promotes a strong public image.

PART C

Question 8

Attempt any four of the following :

- (i) *Explain briefly the role of business in sustainable development in the light of UN Global Compact initiative.*
- (ii) *"The sustainability reporting guidelines developed by the Global Reporting Initiative (GRI), Netherlands, is a significant system that integrates sustainability*

issues into a framework of reporting.” Enumerate the steps to use the GRI reporting framework.

- (iii) State and enumerate corporate sustainability assessment criteria under the Dow-Jones Sustainability Index.*
- (iv) Write note on the ‘Convention on Biological Diversity’.*
- (v) Explain briefly the regulatory framework and the landmark case laws in respect of water pollution. (5 marks each)*

Answer 8(i)

The UN Global Compact is a policy framework for the development, implementation, and disclosure of sustainability principles and practices designed to establish sustainable business models and markets building inclusive global economy.

Trade and Industry being an integral part Human society has a pivotal role to play. In this direction, United Nations has initiated UN Global Compact, a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. Through the process a business can ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere.

The Global Compact is a voluntary corporate citizenship initiative with two objectives:

"Making the Global Compact and its principles part of business strategy and operations."

"Facilitating cooperation among key stakeholders and promoting partnerships in support of U.N. goals."

A company that signs-on to the Global Compact specifically commits itself to:

- set in motion changes to business operations so that the Global Compact and its principles become part of management, strategy, culture, and day-to-day operations;
- publish in its annual report or similar public corporate report (e.g. sustainability report) a description of the ways in which it is supporting the Global Compact and its principles (Communication on Progress),
- publicly advocate the Global Compact and its principles via communications vehicles such as press releases, speeches, etc.

Answer 8(ii)

A sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organization – including both positive and negative contributions.

There are three elements of the GRI Sustainability Reporting Guidelines, viz. Reporting Principles, Reporting Guidance and Standard Disclosures (including performance indicators). These three elements are considered to be equal in weight and importance.

The steps to use the GRI Reporting Framework are as follows:

1. Identify the topics and related indicators that are relevant by undergoing an interactive process using the Principles of materiality and stakeholder inclusiveness, sustainability context, and Report Boundaries.
2. When identifying the topics consider the relevance of all indicator aspects identified in the GRI Guidelines and applicable sector supplements.
3. From the set of relevant topics and indicators, use the tests listed for each Principle to assess which topics and indicators are material.
4. Use the Principles to prioritize selected topics and decide which will be emphasized.
5. The specific methods or processes used for assessing materiality be—
 - Differentiated for and indentified by each organization.
 - Dependent on the guidance and tests found in the GRI Reporting Principles, and
 - Disclosed.

Answer 8(iii)

The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999.

The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index.

Corporate Sustainability Assessment Criteria under the Dow-Jones Indices is as under:

<i>Dimension</i>	<i>Criteria</i>	<i>Weighting (%)</i>
Economic	Codes of Conduct / Compliance /	
	Corruption & Bribery	5.5
	Corporate Governance	6.0
	Risk & Crisis Management	6.0
	Industry Specific Criteria	Depends on Industry
Environment	Environmental Performance	
	(Eco-Efficiency)	7.0
	Environmental Reporting*	3.0
	Industry Specific Criteria	Depends on Industry
Social	Corporate Citizenship/ Philanthropy	3.5
	Labor Practice Indicators	5.0
	Human Capital Development	5.5

Social Reporting*	3.0
Talent Attraction & Retention	5.5
Industry Specific Criteria	Depends on Industry

Documents analyzed include:

- Sustainability reports
- Environmental reports
- Health and safety reports
- Social reports
- Annual financial reports
- Special reports (e.g. on intellectual capital management, corporate governance, R&D, employee relations)
- All other sources of company information; e.g. internal documentation, brochures and website.

Answer 8(iv)

The Convention on Biological Diversity, known informally as the Biodiversity Convention, is an international treaty that was adopted in Rio de Janeiro in June 1992. The Convention has three main goals:

1. conservation of biological diversity;
2. sustainable use of its components; and
3. fair and equitable sharing of benefits arising from genetic resources.

In other words, its objective is to develop national strategies for the conservation and sustainable use of biological diversity. It is often seen as the key document regarding sustainable development.

Some of the issues dealt with under the convention include:

- Measures and incentives for the conservation and sustainable use of biological diversity.
- Regulated access to genetic resources and traditional knowledge, including Prior Informed Consent of the party providing resources.
- Sharing, in a fair and equitable way, the results of research and development and the benefits arising from the commercial and other utilization of genetic resources with the Contracting Party providing such resources (governments and/or local communities that provided the traditional knowledge or biodiversity resources utilized).
- Access to and transfer of technology, including biotechnology, to the governments and/or local communities that provided traditional knowledge and/or biodiversity resources.

- Technical and scientific cooperation.
- Impact assessment.
- Education and public awareness.
- Provision of financial resources.
- National reporting on efforts to implement treaty commitments.

Answer 8(v)**Case-laws on Water Pollution**

The *M C Mehta v. Union of India* (AIR 1988 SC 1037) also known as The Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court of Evidence. The Supreme Court held:

“Where in public interest litigation owners of some of the tanneries discharging effluents from their factories in Ganga and not setting up a primary treatment plant in spite of being asked to do so for several years did not care, in spite of notice to them, even to enter appearances in the Supreme Court to express their willingness to take appropriate steps to establish the pre-treatment plants it was held that so far as they were concerned on order directing them to stop working their tanneries should be passed. It was observed that the effluent discharged from a tannery is ten times noxious when compared with the domestic sewage water which flows into the river from any urban area on its bank. It was further observed that the financial capacity of the tanneries should be considered as irrelevant while requiring them to establish primary treatment plants.

In *Vineet Kumar Mathur v. Union of India* [(1996) 1 SCC 119], the Court took note of the continued violation of the State, as well as industries by continuing to pollute water by discharging effluents and also in not setting up of common effluent treatment plants. The Court initially directed the officers of the State Pollution Board to visit the polluting industrial establishments and make a fresh inspection of the Effluent Treatment Plants installed in the said establishments and of their working. After inspection, if it was found that the treatment plants are deficient in any respect or the deficiency pointed out earlier still continues, the Board will give reasonable time for the industries to cure the deficiencies. However, the time so given should not extend beyond the deadline set up by the Court. The Board was directed to file its report within fifteen days. The Court further held that if the industries do not obtain the consent of the State Pollution Board for running their units, before the fixed time limit the industries will stop functioning there after.

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

*(Answer Question No. 1 which is compulsory
and any two of the rest from this part)*

Question 1

- (a) *“Good governance is decisively the manifestation of personal beliefs and values which configure the organisational values, beliefs and actions of the Board. A properly structured Board capable of taking independent and objective decisions is the pivot of Corporate Governance. A Board should, therefore, be a mix of executive and independent directors with a variety of experience and core competence so that the Board may effectively fulfil their responsibilities by laying down policies and strategies and monitoring managerial performance objectively.”*

In the light of above statement, discuss the role of independent directors in the Corporate Governance and state the provisions of the Companies Act, 1956 and the listing agreement with regard to appointment of independent directors on the Board of directors of a listed company.

(10 marks)

- (b) *State, with reasons in brief, whether the following statements are true or false :*
- (i) *Section 275 of the Companies Act, 1956 stipulates that a person cannot hold office as director in more than fifteen companies at the same time.*
 - (ii) *Control activities are the policies and procedures which ensure that management directives are carried out.*
 - (iii) *Internal auditors play an important role in evaluating the effectiveness of control systems and contribute to ongoing effectiveness.*
 - (iv) *Codification of Corporate Governance in India started with the recommendations of Kumar Mangalam Birla Committee.*
 - (v) *Corporate social responsibility is distinct from corporate philanthropy.*

(2 marks each)

Answer 1(a)

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.

Independent Directors bring a valuable outside perspective to the deliberations. They contribute significantly to the decision-making process of the Board. They can bring an objective view to the evaluation of the performance of Board and management. In addition, they can play an important role in areas where the interest of management,

the company and shareholders may diverge such as executive remuneration, succession planning, changes in corporate control, audit function etc.

Independent directors are required because they perform the following important role :

- (i) Balance the often conflicting interests of the stakeholders.
- (ii) Facilitate withstanding and countering pressures from owners.
- (iii) Fulfill a useful role in succession planning.
- (iv) Act as a coach, mentor and sounding Board for their full time colleagues.
- (v) Provide independent judgment and wider perspectives.

The Board Composition in terms of Clause 49 of the Listing Agreement should be as under:

- (i) The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.
- (ii) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

Explanation - For the purpose of the expression “related to any promoter” referred to in sub-clause (ii):

- (a) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;
- (b) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.”
- (iii) For the purpose of the sub-clause (ii), the expression ‘independent director’ shall mean a non-executive director of the company who:
 - (a) apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
 - (b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
 - (c) has not been an executive of the company in the immediately preceding three financial years;

- (d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company, and
 - (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;
- (f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares;
- (g) is not less than 21 years of age.

Explanation

For the purposes of the sub-clause (iii):

- (a) Associate shall mean a company which is an “associate” as defined in Accounting Standard (AS) 23, “Accounting for Investments in Associates in Consolidated Financial Statements”, issued by the Institute of Chartered Accountants of India.
- (b) “Senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.
- (c) “Relative” shall mean “relative” as defined in section 2(41) and section 6 read with Schedule IA of the Companies Act, 1956.
- (d) Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

Explanation

“Institution for this purpose means a public financial institution as defined in Section 4A of the Companies Act, 1956 or a “corresponding new bank” as defined in section 2(d) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 [both Acts].”

The Companies Act, 1956 does not define independent director. However, independent director has been referred in Schedule XIII to the Companies Act, 1956, wherein it is referred in connection with the composition of Remuneration Committee.

Answer 1(b)(i)

True: Section 275 of the Companies Act, 1956 restricts the number of directorship held by an Individual. It provides that after the commencement of this Act, no person shall, save as otherwise provided in section 276, hold office at the same time as director in more than fifteen companies.

Further, Sec. 278 of the Companies Act, 1956 provides for exclusion of certain directorships for the purpose of Sec. 275 whereby the following companies are excluded:

- (a) a private company which is neither a subsidiary nor a holding company of a public company;
- (b) an unlimited company;
- (c) an association not carrying on business for profit or which prohibits the payment of a dividend;
- (d) a company in which such person is only an alternate director, that is to say, a director who is only qualified to act as such during the absence or incapacity of some other director.

Answer 1(b)(ii)

True : A component of COSO'S Internal Control Framework, control activities are the policies and procedures that help to ensure management directives are carried out. It helps to ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, review of operating performance, security of assets and segregation of duties.

Answer 1(b)(iii)

True : Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often plays a significant monitoring role.

Answer 1(b)(iv)

True : The Kumar Mangalam Birla Committee Report was the first formal and comprehensive attempt to evolve a Code of Corporate Governance, in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets at that time.

The recommendations of the Kumar Mangalam Birla Committee, led to inclusion of Clause 49 in the Listing Agreement in the year 2000. These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations.

Answer 1(b)(v)

True : Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be by an individual or by a corporate.

Corporate Social Responsibility on the other hand is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers,

employees, regulators and the society as a whole. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which drives the CSR initiatives in companies.

Question 2

(a) Write short notes on any three of the following :

- (i) Two-tier Board
- (ii) Whistle blower policy
- (iii) Shareholder activism
- (iv) Corporate Governance Committee. (3 marks each)

(b) You are the Company Secretary of Nodal Power Company Ltd. Your Board of directors wants to understand its responsibilities for reviewing the company's policies on risk oversight and management in the light of listing agreement and satisfy itself whether the management has developed and implemented a sound system of risk management and control.

Prepare a Board note discussing the responsibilities of the Board on risk management and the relevant legal provisions on risk management under the listing agreement. (6 marks)

Answer 2(a)(i)

Two-tier Boards

The two-tier board was developed in its present form in Germany. In a two-tier board there is clear separation between the tasks of monitoring and that of management. The supervisory board (Aufsichtsrat) oversees the direction of the business and the management board (Vorstand) is responsible for the running of the company. The supervisory board controls the management board through appointing its members and through its statutory right to have the final say in major decisions affecting the company. The structure rigorously separates the control function from the management function and members of the one board cannot be members of the other. This separation is enshrined in law and the legal responsibilities of the two sets of board members are different.

The supervisory board system was introduced to strengthen the control of shareholders, particularly the banks, over the companies in which they had invested. Shareholdings are more concentrated in Germany and most quoted companies have at least one major shareholder, often a family or another company. Banks play an important part in governance as investors, lenders and through the votes of individual shareholders for which they hold proxies. They are, therefore, well represented on supervisory boards.

The supervisory board, may have to approve management action, but it is primarily a monitoring body not an initiatory one.

Answer 2(a)(ii)

Whistle Blower Policy

The company may establish a mechanism for employees to report to the management

concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

This is a non-mandatory requirement of clause 49 of Listing Agreement. In case the whistle Blower mechanism is existing, the audit committee is responsible to review the functioning of the Whistle Blower mechanism and a disclosure should be made in the Annual Report about the Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

Answer 2(a)(iii)

Shareholder activism

Shareholder activism refers to the active involvement of stockholders in the organizations they have invested in. Active participation in company meetings is a healthy practice. Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies. They can resolve issues laid down in the annual and other general meetings and can raise concerns over financial matters or even social causes such as protection of the environment. Shareholder activists include public pension funds, mutual funds, unions, religious institutions, universities, foundations, environmental activists and human rights groups.

The shareholder activism means

- Establishing dialogue with the management on issues that concern
- Influencing the corporate culture.
- Using the corporate democracy provided by law.
- Increasing general awareness on social and human rights issues concerning the organization.

Answer 2(a)(iv)

Corporate Governance Committee

A company may constitute Corporate Governance Committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company. Many companies give the mandate of corporate governance to nomination committee and is given the nomenclature Nomination and Corporate Governance Committee.

Typically, Corporate Governance Committee is responsible for considering matters relating to corporate governance including the composition of board, appointment of new directors, review of strategic human resource decisions, succession planning for the chairman and other key board and executive positions, performance evaluation of the board and its committees and individual directors.

Answer 2(b)**Board of Directors****Nodal Power Company Limited.***Sub : Note on Risk Management*

Risk management, in the business context, covers the processes and activities undertaken by an organization to identify, analyse, assess, control and mitigate potential risks and its impact.

The board is responsible for reviewing the company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.

The entire programme must be supported by the board of directors. In larger companies, the board desirably has a risk management committee which controls the overall picture of the uncertainty facing the company. This is because risks are interconnected and interdependent. The approach must include all elements of risks. The traditional elements of potential likelihood and potential consequences of an event must be combined with other factors like the timing of the risks, the correlation of the possibility of an event occurring with others, and the confidence in risk estimates.

Risk management policies should reflect the company's risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function.

A company's risk management policies should clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

A company may designate a Chief Risk Officer manned by an individual with the vision and the diplomatic skills to forge a new approach. He may be supported by "risk groups" to oversee the initial assessment work and to continue the work till it is completed.

An integrated approach to risk management deals with various risks as they affect organizational objectives and limitations. The aim must be to develop a culture of risk awareness and understanding. This helps better decision making in day-to-day work by all employees.

Legal Provisions on Risk Management under the Listing Agreement

In terms of Clause 49 of the Listing Agreement

- the company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.
- Management Discussion & Analysis should include discussion on
 1. Risks and concerns.
 2. Internal control systems and their adequacy.

Sd/-

Company Secretary

Question 3

- (a) *“Constructive insiders are also liable for insider trading violations if the company expects the information to remain confidential, since they acquire the fiduciary duties of the true insiders.” Discuss the statement in the light of decided cases.* (7 marks)
- (b) *Describe how the OECD principles of Corporate Governance helped in evolution and development of Corporate Governance.* (4 marks)
- (c) *“Chairmen have no legal position.” Elucidate.* (4 marks)

Answer 3(a)

The Dirks case in USA also defined the concept of “constructive insiders,” to include lawyers, investment bankers and others who receive confidential information from a corporation while providing services to the corporation. Constructive insiders are also liable for insider trading violations if the corporation expects the information to remain confidential, since they acquire the fiduciary duties of the true insider.

In 1984, the Supreme Court of the United States ruled in the case of *Dirks v. SEC* that tippees (receivers of second-hand information) are liable if they had reason to believe that the tipper had breached a fiduciary duty in disclosing confidential information and the tipper received any personal benefit from the disclosure. (Since Dirks disclosed the information in order to expose a fraud, rather than for personal gain, nobody was liable for insider trading violations in his case.)

In *SEC v. Texas Gulf Sulphur Co.* (1966), a federal circuit court stated that anyone in possession of inside information must either disclose the information or refrain from trading.

SEBI the Market regulator has put in place a comprehensive Integrated Market Surveillance System to track trading data from all the market participants stock exchanges, depository participants, custodians as well as data of clearing houses. This system is expected to help it detect potential and accomplished insider trading and manipulation or fraud violations across financial instruments and markets.

Answer 3(b)**OECD principles of Corporate Governance**

The Organisation for Economic Co-operation and Development (OECD) was established in 1961. The OECD was one of the first non-government organizations to spell out the principles that should govern corporates.

The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of the 30 countries that are members of the OECD. They were designed to assist governments and regulatory bodies in both OECD countries and elsewhere in drawing up and enforcing effective rules, regulations and codes of corporate governance. They also provide guidance for stock-exchanges, investors, companies and others that have a role in the process of developing good corporate governance.

The original OECD Principles were issued in 1999, they became a generally accepted standard in this area. The original principles of OECD were revised and the revised principles were issued in 2004. The revision of the original principles was to take into account the developments and the corporate governance scandals highlighted the need for improved standards. It was recognized that the integrity of the stock market was critical and to the revised principles were designed to underpin this integrity.

The OECD Principles of Corporate Governance cover six main areas.

- (a) They call on governments to have in place an effective institutional and legal framework to support good corporate governance practices .
- (b) They call for a corporate governance framework that protects and facilitates the exercise of shareholders' rights .
- (c) They also strongly support the equal treatment of all shareholders, including minority and foreign shareholders.
- (d) They recognise the importance of the role of stakeholders in corporate governance.
- (e) They look at the importance of timely, accurate and transparent disclosure mechanisms
- (f) They deal with board structures, responsibilities and procedures.

The OECD Principles of Corporate Governance has provided governments, regulators and other standard setters with an international benchmark. The OECD works closely with a large number of developing and emerging market countries. In particular, the OECD organises Regional Corporate Governance Roundtables in Asia, Latin America, Eurasia, Southeast Europe and Russia. These Roundtables have used the OECD Principles to formulate regional reform priorities and are now actively engaged in implementing these recommendations.

Answer 3(c)

The responsibility for ensuring that boards provide the leadership which is expected of them is that of their chairmen. Chairmen, however, have no legal position; they are whoever the board elects to take the chair at a particular meeting. Boards are not bound to continue with the same chairman for successive meetings. In law, all directors have broadly equal responsibilities and chairmen are no more equal than any other board member. Chairmen are an administrative convenience and a means of ensuring that board meetings are properly conducted.

Thus from a statutory point, in terms of Companies Act, 1956, of view there is no necessity for a board to have a continuing chairman. The chairmanship could, for example, rotate among board members. Although board chairmen have no statutory position, the choice of who is to fill that post is crucial to board effectiveness. If the chairman is not upto the task, it is improbable that the meeting will achieve anything but frustration and waste of that most precious of resources—time. Continuity and competence of Chairmanship is vital to the contribution which boards make to their companies.

On the other hand, in terms of Clause 49 of the listing agreement, the composition of board (i.e. proportion of independent directors in the board) is dependent upon whether the Chairman is executive or non-executive as also whether the chairman is a promoter or relative of promoter.

Question 4

- (a) *You are the Company Secretary of Beware Ltd., listed in the London Stock Exchange. Prepare a brief note to the Chairman highlighting the relevant provisions of the UK Combined Code on Corporate Governance stating the factors determining independence of the directors under the UK law. (7 marks)*
- (b) *“The institutional investors use different tools to assess the health of the company before making investment of funds.” Discuss some of the important tools used by the institutional investors for this purpose. (4 marks)*
- (c) *“Corporate communication comprises both — external as well as internal communication.” Elaborate this statement. (4 marks)*

Answer 4(a)

The Chairman Beware Ltd.

Sub: Note on factor determining Independence of Directors

Corporate governance regulation and practice is deeply-routed in the UK. The first mainstream best practice corporate governance codes were published in the early 1990s and there has been a Combined Code against which listed companies have to report, on the comply or explain basis, since 1998. Key aspects of corporate governance in the UK are:

- a single board with checks and balances;
- effective rights for shareholders;
- transparency; and
- a best practice code on corporate governance, operating on a comply or explain basis.

The Combined Code is voluntary. However, the Listing Rules require UK incorporated listed companies, in their annual accounts, to (i) report on how they apply its main principles and (ii) either confirm that they comply with its detailed provisions or explain their non-compliance (known as the “comply or explain” basis).

Board Structure

The code requires that at least half the board, excluding the chairman, should comprise independent non-executive directors. A smaller company should have at least two independent non-executive directors.

Criteria for independence of director

The following factors are relevant in determining the independence of director:

- has been an employee of the company or group within the last five years;

- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

Senior Independent Director

The code requires the board to appoint one of the independent non-executive directors to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which have remained unresolved in spite of taking up with chairman, chief executive or finance director.

Further, the UK Code provides for the constitution of following committees:

- Audit Committee
- Remuneration Committee
- Nomination Committee

Sd/-

Company Secretary

Answer 4(b)

Tools Used by Institutional Investors

The Institutional Investors use different tools to assess the health of company before investing resources in it. Some of the important tools are discussed as under:

(i) *One-to-one meetings*

The meetings between institutional investors and companies are extremely important as a means of communication between the two parties. This is one clear example of the way that individual investors are at a disadvantage to institutional investors as corporate management will usually only arrange such meetings with large investors who are overwhelmingly institutional investors. A company will usually arrange to meet with its largest institutional investors on a one-to-one basis during the course of the year

(ii) *Voting*

The right to vote can be seen as fundamental tools for some element of control by shareholders. The institutional investors can register their views by postal

voting, or, vote electronically where this facility is available. Most of the large institutional investors now have a policy of trying to vote on all issues which may be raised at their investee company's AGM. Some may vote directly on all resolutions, others may appoint a proxy (which may be a board member).

(iii) *Focus lists*

A number of institutional investors have established 'focus lists' whereby they target underperforming companies and include them on a list of companies which have underperformed a main index, such as Standard and Poor's. Underperforming the index would be a first point of identification, other factors would include not responding appropriately to the institutional investor's enquiries regarding underperformance, and not taking account of the institutional investor's views. After being put on the focus list, the companies often receive unwanted, attention of the institutional investors who may seek to change various directors on the board.

(iv) *Corporate governance rating systems*

With the increasing emphasis on corporate governance across the globe, it is perhaps not surprising that a number of corporate governance rating systems have been developed. These corporate governance rating systems should be of benefit to investors, both potential and those presently invested, and to the companies themselves.

In turn, the ratings will also be useful to governments in identifying perceived levels of corporate governance in their country compared to other countries in their region, or outside it, whose companies may be competing for limited foreign investment. In emerging market countries in particular, those companies with a corporate governance infrastructure will, *ceteris paribus*, be less subject to cronyism and its attendant effects on corporate wealth. These companies would tend to be more transparent and accountable, and hence more attractive to foreign investors.

Answer 4(c)

Corporate communication means the corporation's voice and the images it projects of itself to the various stakeholders. This includes various areas such as corporate reputation, corporate advertising, and employee communications, government relations and media management. These days most of the bigger organizations have departments of corporate communication which appears on the organizational chart along with traditional functions like marketing or accounting.

The corporate communication can also be defined as the processes a company uses to communicate all its messages to key constituencies –

- a combination of meetings,
- interviews,
- speeches,
- reports,
- images

- advertising, and
- on-line communication.

Corporate communication comprises both external and internal communications. The external communication may be media relation, an external event, company profiling etc. Internal communication would be addressed to employees, crisis management and so on.

(a) *Media Relations*

This involves building and maintaining a positive relationship with the media (TV, print, web etc. Be it drafting and dissemination of press releases, organizing press conferences and meeting with media professionals, events for media etc.

(b) *External event*

Could involve vendor/supplier/distributor meets, channel partner meetings, events related to product launches, important initiatives etc.

(c) *Company/Spokesperson profiling*

Ensuring that the company/organization spokesperson is in the public limelight, is well-known and considered as an authority for the respective sector/field.

- Management of company internet/web portals/other external touch points
- Managing company publication - for the external world manage Print Media

(d) *Internal communications*

- Managing company publication - for employees and partners

(e) *Employee communications*

- Sharing information with employees, building employer pride, managing employee issues, etc.
- Manage Intranet and other internal web portals

(f) *Brand management*

- Develop and upkeep the corporate identity - ensure adherences to corporate brand guidelines

(g) *Crisis communication*

- Manage crisis situations through effective communication

PART B

(Answer **any two** questions from this part.)

Question 5

- (a) *You are the Company Secretary of Dia Pipes Ltd. The Board of directors desires to know from you the 'best practices in ethics programme'. Draft a precise ten point best practices in ethics programme for consideration of the Board of directors.* (7 marks)

- (b) *Discuss the concept of 'ethics philosophies'.* (4 marks)
- (c) *"The Caux Round Table (CRT) is based on the belief that the world business community should play an important role in improving economic and social conditions." In the light of this statement, enumerate the CRT general principles for business.* (4 marks)

Answer 5(a)

Board of Directors Dia Pipes Limited

Sub: Best Practices in Ethics Programme

A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate. Following are the best practices which should be considered in Ethics programme:

- Constitute an ethics committee. The recommendations of the ethics committee should include staff training, evaluations of compliance systems, appropriate funding and staffing of the corporate ethics office, and effective protections to employees who "blow the whistle" on perceived actions contrary to the spirit and/or letter of the Code.
- Annual training on the code is a good practice. Many corporations establish independent "hot lines" or "help lines" where employees can seek guidance when they are faced with an ethical dilemma or when they encounter unethical conduct in the workplace.
- Establishing a regular review system to ensure the Code is dynamic and updated in the light of new developments.
- Every member of the Board of Directors should be required to sign the Code of Ethics and pledge that she or he will never support a Board motion to suspend the Code.
- All outside law firms and auditing firms that consult to publicly listed corporations should be required to sign statements noting that they understand and accept the corporation's Code of Ethics.
- Employees basically want to know two things- (a) know what is expected or required for them to survive and to be successful (b) know "how they were doing" at that point in time.

The following - Goals, Roles, Expectations and Priorities should be communicated to the employees:

- People should be reminded/repeatedly communicated of the short term and long term goals of the job. They should see how their goals support the organization's mission and vision. Employees should be made aware that how a goal is accomplished was just as important as accomplishing the goal itself. Cutting corners could hurt the corporation, its reputation and, eventually, the individual employee.

- Employees should know how their job fits into the bigger picture which will remind them of their importance and value ensure that they understand their role and ensure that they understand what kind of conduct was expected is very important.
- Employees should understand exactly what was expected, what had to be done, when, to what standards, how would it be evaluated, what should they do if they encountered any hurdle or unanticipated changes, how conflicts should be handled.
- Employees should have clarity of the organization's operational priorities.

XYZ

Company Secretary

Answer 5(b)

The following are some of the ethics philosophies:

Deontological ethics or deontology [Greek : (*deon*) meaning 'obligation' or 'duty'] is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions. Thus, the term 'deontological' picked out the set of ethical theories that are based on the idea that an action's being right or wrong is basic, and whether a situation is good or bad depends on whether the action that brought it about was right or wrong. This can be clarified with an example – if a manager decides that it is his duty to always be on time to meetings is running late for reasons not in his control, how is he supposed to drive to reach the meeting on time ? Is he supposed to speed, breaking his duty to uphold the law, or is he supposed to arrive at his meeting late, breaking his duty to be on time ?

Teleology (Greek : *telos*: end, purpose) is the philosophical study of design and purpose. A teleological school of thought is one that holds all things to be designed for or directed toward a final result, that there is an inherent purpose or final cause for all that exists.

Enlightened-egoism. This model takes into account harms, benefits and rights. Therefore, under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company's providing the scholarship benefits the needy students, but ultimately it is in the company's self interest.

Utilitarianism is the idea that the moral worth of an action is solely determined by its contribution to overall utility, that is, its contribution to happiness or pleasure as summed among all persons. It can be described by the phrase "the greatest good for the greatest number". For example, one may be tempted to steal from a rich wastrel to give to a starving family.

Relativism is the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects. The term often refers to truth relativism, which is the doctrine that there are no absolute truths, i.e., that truth is always relative to some particular frame of reference, such as a language or a

culture. For example, killing animals for sport (like bull fighting) could be right for one culture and wrong in another culture.

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen article.

Justice is the concept of moral rightness in action or attitude; it is closely linked to fairness. A conception of justice is one of the key features of society.

Answer 5(c)

The CRT Principles for Business were formally launched in 1994, and presented at the United Nations World Summit on Social Development in 1995. The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. The CRT Principles for Business emerged from a series of dialogues catalyzed by the Caux Round Table during the late 1980's and early 1990's. The Principles are comprehensive statement of responsible business practice formulated by business leaders for business leaders.

These principles are rooted in two basic ethical ideals: *kyosei* and human dignity. The Japanese concept of “*kyosei*” means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition.

“Human dignity” refers to the sacredness or value of each person as an end, not simply as a mean to the fulfillment of others' purposes or even majority prescription. These principles are as follow:

Principle 1

The Responsibilities of Businesses: Beyond Shareholders toward Stakeholders

Principle 2

The Economic and Social Impact of Business: Toward Innovation, Justice and World Community

Principle 3

Business Behavior: Beyond the Letter of Law : Toward a Spirit of Trust

Principle 4 - Respect for Rules

Principle 5 - Support for Multilateral Trade

Principle 6 - Respect for the Environment

Principle 7 - Avoidance of Illicit Operations

Question 6

- (a) *“The Board of directors holds ultimate responsibility for their company’s success or failure as well as for ethics of their decisions.” In the light of this statement, discuss the role of Board of directors in shaping the ethical climate of a company.*
(7 marks)

(b) *Elaborate the concept of 'stakeholders'.* (4 marks)

(c) *Write a note on 'social and ethical accounting'.* (4 marks)

Answer 6(a)

Role of Board of Directors in Shaping the Ethical Climate

The board of directors hold the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions. The ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. What top management does, and the culture they establish and reinforce, makes a huge difference in the way lower-level employees act and in the way the organization as a whole acts when ethical dilemmas are faced. When the ethical climate is not clear and positive, ethical dilemmas will often result in unethical behavior.

The directors on a company's board assume legal responsibility for the firm's resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company's approach towards ethical issues and stakeholder interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

Answer 6(b)

In a business context, customers, investors and shareholders, employees, suppliers, government agencies, communities, and many others who have a "stake" or claim in some aspect of a company's products, operations, markets, industry, and outcomes are known as stakeholders. These groups are influenced by business, but they also have the ability to affect businesses.

Stakeholders provide resources that are more or less critical to a firm's long-term success. These resources may be both tangible and intangible. Shareholders, for example,

supply capital; suppliers offer material resources or intangible knowledge; employees and managers grant expertise, leadership, and commitment; customers generate revenue and provide infrastructure; and the media transmits positive corporate images.

The classic definition of a stakeholder is 'any group or individual who can affect or is affected by the achievement of the organization's objectives (Freeman 1984:46).

The concept was elaborated by Evans & Freeman as the following two principles:

1. *Principles of corporate legitimacy*

The corporation should be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees & local communities. The rights of these groups must participate, in some sense, in decisions that substantially affect their welfare.

2. *The stakeholder fiduciary principle*

Management bears a fiduciary relationship to stakeholders and to the corporation as an abstract entity. It must act in the interest of the stakeholders as their agent, and it must act in the interests of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of each group.

Another definition given subsequently by Freeman of Stakeholder: "Those groups who are vital to the survival & success of the corporation" and the two principles were altered and renamed:

1. *The stakeholder enabling principle*

Corporations shall be managed in the interest of stakeholders.

2. *The principle of director responsibility*

Directors of a corporation shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the stakeholder enabling principle

Two types of Stakeholders

Primary stakeholders are those whose continued association is absolutely necessary for a firm's survival; these include employees, customers, investors, and shareholders, as well as the governments and communities that provide necessary infrastructure.

Secondary stakeholders do not typically engage in transactions with a company and thus are not essential for its survival; these include the media, trade associations, and special interest groups.

Answer 6(c)

Social and Ethical Accounting

Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the development of policies and performance targets and to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized

balance sheet or unit of currency. The issues are defined by the company's values and aims by the interests and expectations of its stakeholders, and by societal norms and regulations. With the focus on the concerns of society, the social and ethical accounting framework implicitly concerns itself with issues such as economic performance, working conditions, environmental and animal protection, human rights, fair trade and ethical trade, human resource management and community development, and hence with the sustainability of a company's activities.

Principles of social and ethical accounting

The dominant principle of social and ethical accounting is inclusivity. This principle requires that the aspirations and needs of all stakeholder groups are taken into account at all stages of the social and ethical accounting process.

- *Planning* : The company commits to the process of social and ethical accounting, auditing and reporting, and defines and reviews its values and social and ethical objectives and targets.
- *Accounting* : The scope of the process is defined, information is collated and analysed, and performance targets and improvement plans are developed.
- *Reporting* : A report on the company's systems and performance is prepared.
- *Auditing* : The process of preparing the report and the report itself are externally audited, and the report is made accessible to stakeholders in order to obtain feedback from them.
- *Embedding* : To support each of the stages, structures and systems are developed to strengthen the process and to integrate it into the company's activities.
- *Stakeholder engagement* : The concerns of stakeholders are addressed at each stage of the process through regular involvement.

The nature of social and ethical reporting is related to the size and nature of the organization. However comprehensive and clear a report is, it needs to be trusted to be valuable.

Question 7

- (a) *Your company is listed in the Bombay Stock Exchange. There is a proposal to set-up its business in USA. You are required to prepare a brief note for the Chairman explaining the code of conduct and business ethics in both the countries.* (7 marks)
- (b) *Discuss the Clarkson Principle of Stakeholder Management.* (4 marks)
- (c) *Write a note on 'ethics training and communication'.* (4 marks)

Answer 7(a)

The Chairman
XYZ Limited

Sub: Note on Code of Conduct and Business Ethics

In India, Clause 49 of the Listing Agreement requires that

- (i) The Board shall lay down a code of conduct for all Board members and senior

management of the company. The code of conduct shall be posted on the website of the company.

- (ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

In the United States of America, Section 406 of the Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have codes of ethics and also to disclose any waivers of those codes for certain members of senior management.

Section 406 of Regulation S-K which is a prescribed regulation under the US Securities Act, requires companies to disclose:

- whether they have a written code of ethics that applies to their principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions;
- any waivers of the code of ethics for these individuals; and
- any changes to the code of ethics.

If companies do not have a code of ethics, they must explain why they have not adopted one. A company may either file its code as an exhibit to the annual report, post the code on the company's Web site, or agree to provide a copy of the code upon request and without charge.

Code of Conduct

Code of conduct popularly known as Code of Business Conduct contains standards of business conduct that must guide actions of the Board and senior management of the Company.

The Code may include the following:

- (a) Company Values.
- (b) Avoidance of conflict of interest.
- (c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company's other communications.
- (d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations.
- (e) Maintaining confidentiality of Company affairs.
- (f) Non-competition with Company and maintaining fair dealings with the Company.
- (g) Standards of business conduct for Company's customers, communities, suppliers, shareholders, competitors, employees.
- (h) Prohibition of Directors and senior management from taking corporate opportunities for themselves or their families.
- (i) Review of the adequacy of the Code annually by the Board.
- (j) No authority of waiver of the Code for anyone should be given.

The Code of Conduct for each Company summarises its philosophy of doing business.

To create a code of ethics, an organization must define its most important guiding values, formulate behavioral standards to illustrate the application of those values to the roles and responsibilities of the persons affected, review the existing procedures for guidance and direction as to how those values and standards are typically applied, and establish the systems and processes to ensure that the code is implemented and effective. Codes of ethics are not easily created from boilerplate. Ideally, the development of a code will be a process in which Boards and senior management actively debate and decide core values, roles, responsibilities, expectations, and behavioral standards.

Sd/-

(ABC)

Answer 7(b)

The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics:

Principle 1: Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2: Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3: Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4: Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

Principle 5: Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6: Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 7(c)

Ethics Training and Communication

A major step in developing an effective ethics program is implementing a training

program and communication system to communicate and educate employees about the firm's ethical standards.

Training can educate employees about the firm's policies and expectations, as well as relevant laws and regulations and general social standards. Training programs can make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice. They can also empower employees to ask tough questions and make ethical decisions. Many companies are now incorporating ethics training into their employee and management development training efforts.

If ethics training is to be effective, it must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program. Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics.

To be successful, business ethics programs should educate employees about formal ethical frameworks and more for analyzing business ethics issue. Then employees can base ethical decisions on their knowledge of choices rather than on emotions.

Written standards deter wrongdoing and promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the [company];
3. Compliance with applicable governmental laws, rules and regulations;
4. The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and,
5. Accountability for adherence to the code.

PART C

Question 8

Attempt any four of the following :

- (i) *"The International Labour Organisation (ILO) is the only tripartite United Nations agency that brings together representatives of governments, employers and workers to jointly shape policies and programmes to achieve its defined objectives." Elucidate.*
- (ii) *Write a note on 'hazardous or inherently dangerous industry'.*
- (iii) *"Just like an industry which cannot pay minimum wages to its workers cannot be allowed to exist, a tannery which cannot set-up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effects on the public at large." Discuss this statement with the relevant case law.*

- (iv) *“Corporate sustainability encompasses strategies and practices that aim to meet the needs of stakeholders today while reaching to protect, support and enhance the human and natural resources that will be needed in the future.” In the light of this statement, discuss the key drivers which need to be garnered to ensure sustainability.*
- (v) *“The Bali Road Map consists of a number of forward looking decisions that represent the various tracks essential to reaching a secure climate future.” Discuss.* (5 marks each)

Answer 8(i)

The International Labour Organisation (ILO) was created in 1919, as part of the Treaty of Versailles that ended World War I, to reflect the belief that universal and lasting peace can be accomplished only if it is based on social justice. The security, humanitarian, political and economic considerations, were the driving force behind the creation of ILO.

There was keen appreciation of the importance of social justice in securing peace, against a background of exploitation of workers in the industrializing nations of that time. There was also increasing understanding of the world's economic interdependence and the need for cooperation to obtain similarity of working conditions in countries competing for markets. Reflecting these ideas, the Preamble states:

- Whereas universal and lasting peace can be established only if it is based upon social justice;
- And whereas conditions of labour exist involving such injustice hardship and privation to large numbers of people as to produce unrest so great that the peace and harmony of the world are imperilled; and an improvement of those conditions is urgently required;
- Whereas also the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries.

The areas of improvement listed in the Preamble remain relevant today, for example:

- Regulation of the hours of work including the establishment of a maximum working day and week;
- Regulation of labour supply, prevention of unemployment and provision of an adequate living wage;
- Protection of the worker against sickness, disease and injury arising out of employment;
- Protection of children, young persons and women;
- Provision for old age and injury, protection of the interests of workers when employed in countries other than their own;
- Recognition of the principle of equal remuneration for work of equal value;
- Recognition of the principle of freedom of association;
- Organization of vocational and technical education, and other measures.

The ILO is the only 'tripartite' United Nations agency that brings together

representatives of governments, employers and workers to jointly shape policies and programmes, to achieve its defined objectives.

Answer 8(ii)

Hazardous or inherently dangerous industry

The industries involving hazardous processes generally handle many toxic, reactive, and flammable chemical substances in the plant operations which are potential sources of different types of hazards at the workplace. If these hazards are not managed properly, the safety and health of the exposed population is adversely affected and become vulnerable to great risk.

In *M.C. Mehta v. Union of India*, AIR 1987 SC 1086, the Supreme Court stated that “an enterprise which is engaged in a hazardous or inherently dangerous activity that poses a potential threat to the health and safety of persons and owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone. *The principle of absolute liability is operative without any exceptions. It does not admit of the defences of reasonable and due care, unlike strict liability. Thus, when an enterprise is engaged in hazardous activity and harm result, it is absolutely liable.*

Answer 8(iii)

The given statement is part of Supreme Court observation in M.C. Mehta v. Union of India case, which is detailed below:

The *M.C. Mehta v. Union of India* [AIR 1988 SC 1037] also known as the Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court as evidence.

In the case following the alarming details given by M.C. Mehta about the extent of pollution in the river Ganga due to the inflow of sewage from Kanpur only, the Court came down heavily on the Nagar Mahapalika (Municipality) and emphasised that it is the Nagar Mahapalika of Kanpur that has to bear the major responsibility for the pollution of the river near Kanpur city. The Supreme Court held:

“Where in public interest litigation owners of some of the tanneries discharging effluents from their factories in Ganga and not setting up a primary treatment plant in spite of being asked to do so for several years did not care, in spite of notice to them, even to enter appearances in the Supreme Court to express their willingness to take appropriate steps to establish the pre-treatment plants it was held that so far as they were concerned on order directing them to stop working their tanneries should be passed. It was observed that the effluent discharged from a tannery is ten times noxious when compared with the domestic sewage water which flows into the river from any urban area on its bank. It was further observed that the financial capacity of the tanneries should be considered as irrelevant while requiring them to establish primary treatment plants. **Just like an industry which cannot pay minimum wages to its worker cannot be allowed to exist, a tannery which cannot set up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effect on the public at large** which is likely to ensure by the discharging of the trade effluents from the tannery to the river Ganga would be immense and it will outweigh any inconvenience that may be caused to the management and the labour employed by it on account of its closure”.

Again in *M.C. Mehta v. Union of India* [1997(2) SCC 411], the Supreme Court was concerned about the discharge of untreated effluents into the river Ganga by tanneries located in Calcutta. According to the Court the scope of the direction issued to the city of Kanpur was enlarged to include various cities located on the banks of the River Ganga.

Answer 8(iv)

Corporate sustainability encompasses strategies and practices that aim to meet the needs of stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future.

Concern towards social, environmental and economical issues, i.e., covering all the segments of stakeholders are now basic and fundamental issues which permits a corporate to operate in long run sustainably. Following key drivers need to be garnered to ensure sustainability

- *Internal Capacity Building strength* – In order to convert various risks into competitive advantage.
- *Social impact assessment* – In order to become sensitive to various social factors, like changes in culture , living habits etc.
- *Repositioning capability* through development and innovation Crystallisation of all activities to ensure consistent growth
- *Corporate sustainability* is a business approach creating shareholder value in long run.

These may be derived by converting risks arising out of economic, environmental and social activities of a corporate into business opportunities keeping in mind the principles of sustainable development.

Answer 8(v)

At the 2007 United Nations Climate Change Conference in Bali, Indonesia in December, 2007, the participating national adopted the Bali Roadmap as a two-year process to finalizing a binding agreement in 2009 in Denmark.

The Bali Road Map consists of a number of forward-looking decisions that represent the various tracks, essential to reaching a secure climate future. The Bali Road Map includes the Bali Action Plan, which charts the course for a new negotiating process designed to tackle climate change, with the aim of completing this by 2009. To conduct the process, a subsidiary body under the Convention was set up, called the Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA).

To discuss future commitments for industrialized countries under the Kyoto Protocol, the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol established a working group in December 2005, called the Ad Hoc Working Group on further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP).
